S1 2016 Earnings Call

Company Participants

- Chris Figee, Chief Financial Officer
- Jos Baeten, Chief Executive Officer
- Michel Hulters, Head of Investor Relations

Other Participants

- Albert Ploegh, Analyst
- Angel Kansagra, Analyst
- Ashik Musaddi, Analyst
- Bart Horsten, Analyst
- Benoit Petrarque, Analyst
- Matthias de Wit, Analyst
- Ron Heydenrijk, Analyst

Presentation

Operator

Ladies and gentlemen, good day and welcome to the ASR Conference Call on the First Half Year Results of 2016. Today's conference is being recorded.

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

Michel Hulters {BIO 19111905 <GO>}

Thank you, operator. Good afternoon and good morning to those of you listening-in from the US. Welcome to ASR's conference call on its first half year results of 2016. Presenting today are Jos Baeten, CEO; and Chris Figee, CFO.

Jos will start today's presentation with the highlights of our financial performance, and he will also discuss the most recent business developments; and Chris will then provide further detail on our financial performance, the investment portfolio and last but not least, our solvency and capital position. Following the presentation, there will be ample opportunity to ask questions, but please do also review our disclaimer on forward-looking statements in the back of the presentation.

Having said that, Jos, the floor is yours.

Jos Baeten {BIO 2036695 <GO>}

Thanks, Michel. Good day, everybody. Thanks for joining us. Michel already mentioned I would discuss some highlights. I think that the main highlight in the first half year for ASR was our very successful IPO. It was an exciting and challenging period for us and we are happy we succeeded just for Brexit. And following these intense periods of preparation and having met a lot of potential investors, it has been very rewarding to find such strong support for our equity story and today will be the first time, we report on the progress on our equity story.

Our strategic principle is, as you know, value-over-volume. Now, we believe that with our customer orientation very important in the Dutch markets, strong underwriting skills and financial discipline, we are able to generate organic capital for the long-term. And this organic capital generation for the long-term will be in line with our guidance as communicated at IPO, assuming that UFR drag as it is for -- assuming UFR drag as it is for today. We truly appreciate the trust and confidence our existing and new shareholders have given us at IPO. We look forward to building a constructive dialog with them as our shareholders and with the wider analyst community.

So let's now talk about our first half year results. We're very pleased to be able to report a very solid and strong results for the first six months of 2016. We believe our financial performance, strong solvency position and organical -- organic capital generation underpin our equity story. Our performance is in line with or even better than the targets we have set for the medium-term. Our capital position was further strengthened by high operating results and favorable impact from financial markets.

Solvency ratio, by the way, we still use the standard model is strong at 191; and this is exclusively the effect of the recent agreed mass lapse reinsurance contract, which would add another 5% of SCR; and is comfortably above our 160, management threshold. So our strong solvency level enables us to remain entrepreneurial and to pursue profitable growth going forward.

Organic capital generation has remained strong as it was in 2015 and amounted EUR159 million, representing 4.7% of the required capital. This number, by the way, already includes the additional UFR drag roughly 75 million, as a result of a decline in interest rates; and it also includes the run-off of the equity transitional roughly 21 million.

The return on our investment portfolio exceeded our assumption, so additional to the organic capital generation, we had a 6% of extra capital generation on our SCR. Chris, later on in the presentation will provide further detail on our investment portfolio and the capital generation and how we realized it.

At the level of all of our operating units, we maintain solid solvency positions, so all are above there and our thresholds. So cash remittance to the holding today is on track. We expect to meet the targeted cash position as we communicated of EUR360 million at the end of the year. Mid-year cash at the holding amounted to EUR181 million.

Talking about the operating result, this operating result is mainly driven by our strong business performance, as well in life as in non-life. The increase in the Life segment reflects higher investment income and the contribution of the recently acquired businesses of Axent, De Eendragt and NIVO.

Our Non-life operating result, as you may have seen includes a significant hail and water damage claims. These claims amounted to EUR25 million after reinsurance; I will come to that in a moment. Absorbing these claims led to a combined ratio of 96.4; still ahead of our target of our medium term target of 96% for this year. So I think we've done very well despite the severe hail storms we had in the Netherlands and we show better combined ratios than the average Dutch market.

Excluding these exceptional claims, by the way, combined ratio would be 94.2. Talking about only the P&C business, the combined ratio including the claims for hail and water was 99.5 and excluding 94.6. And finally on our financial results, the operating return on equity for our business was 14.5 and remained well above the medium term target, which was up to 12.

Let's go to slide number three and at the introduction of the equity story of ASR, we have discussed the way we run our diversified portfolio. The key message there is, we focus on value creation. ASR's equity story is about cash generation and we have a very structured and disciplined approach for reviewing all of our businesses and assess potential opportunities in the market.

And let me summarize our portfolio as we see it today and talk a little bit about the achievements, which we've made during the first half of 2016. First of all, we have several stable cash flow and value generating businesses mainly in the Non-life area. We consider those business as business with a relatively strong growth potential and we focus running those operations, cost-effective, focus on profitable underwriting as proven in our numbers over the first half year and delivering absolute style returns.

For example, last year, ASR had the highest absolute return in Non-life and also having seen some of the numbers of our competitors in the first half year, our absolute return in Non-life was the highest in the Dutch market. Our focus in those areas is predominantly on organic growth, expanding in distribution and expanding in underwriting skills. The achievements in the first half year in this area was that we have announced the acquisitions of -- the acquisition of Corins; and Corins -- the acquisition of Corins means investment in underwriting skills. So it is a capital-light investment, we didn't need a lot of capital for that and now we are able to grow our non-life market for especially small and medium-sized companies.

Second area of our business is our service book area or, if you want, our closed books especially in individual life and pension DB. Our focus in this area is preserved value by lowering and variabilizing the costs, limit unnatural lapses and balancing longevity and mortality risk. And if there are any closed books available, we always will have a look at them especially if they at mortality risk. What we've done in the first half year our achievements over there, we are on track with our back book conversion, which means that we are on track with variabilizing our cost in the individual life area. And with the acquisition of NIVO, we have acquired mortality risk helping to offset the longevity risk in our books.

Let me talk about the third area of our portfolio, which is the capital-light growth opportunities area, where we can either grow organically or inorganically, such as in pensions DC, asset management and distribution and services.

Achievements in this area is -- in the pension DC market, we have seen strong increase in the sales of our employee pension product. We almost doubled the portfolio, mainly in small and medium enterprises. At the same time, we feel price pressure in the corporate DC market; and we are currently carefully balancing between increasing our market share in this area and profitable growth. So the shift from DB to DC is happening, be it in a slow pace.

And asset management, we have closed, in the meantime, and integrated the acquisition of BNG, is now part of ASR that was done in the second quarter and there we have added third-party asset management capabilities and 5 billion of assets under management.

And finally, we've announced the acquisition of SuperGarant, a large Dutch broker specialized in disability, that was announced in July and this adds disability distribution skills. Another capital-light initiative we've taken and already talked about is the APF. Our application for the APF has been filed and is currently awaiting approval by the regulator. So hopefully, this will be in the next quarter. Finally, we also there to divest. Last half year, we have divested two businesses, SOS Alarmcentrale and most of our real estate development projects because for both businesses we felt no longer the right owner for this business.

So let's turn to page four and have a look to the effect of all of those acquisitions. Most acquisitions drive -- had driven the increase in our premium income. 377 million of the premium income in life was due to acquisition. They also drove the cost base in the first half year, I will talk about it in a minute.

Life premium income, first half year, was up 14% to over 1.3 billion and, as such, driven by the acquired businesses, but not only by those businesses, we were also successful in getting new business. Part of the growth here was due to large new contracts such as the transaction of

AstraZeneca. The operational profit contribution from the acquired businesses during the first half was EUR22 million, so they add really value to ASR. All acquisitions, by the way, met our investment criteria as defined upfront.

In non-life, premium income increased slightly to 1.4 billion due to organic increase of the volumes in mainly P&C and disability. Of course, acquired businesses also raised the cost base, so let's turn to the operating expenses on the next slide, which is slide five. Over the last few years, ASR is known for its capabilities to reduce costs on an ongoing basis. Cost efficiency is part of the day-to-day business culture, and the underlying cost decline is ongoing. For the medium-term, we've announced a cost reduction of 50 million and we are on track to meet the medium-term target. With the addition of the cost base of the acquired businesses, our operating expenses went up to 283. Excluding those acquisitions, our operating expenses were stable.

Despite, we had to absorb roughly 8 million of one-off costs related to the IPO. So if I take out the one-off IPO costs, the underlying cost decrease is ongoing, which is also proven by the decrease of the number of FTEs, as you can see on the right side of the slide. So cost is on schedule.

Let's move to page six and talk a little bit about our operating result. As mentioned, it went up 4.3% to 292. The operating result in non-life, as such, decreased by 52 million. This was mainly due to the hail and water damage, 25 million after reinsurance and 34 million before reinsurance, so 9 million was covered by our reinsurance contracts. And further, last year, we had higher results in the comparable period in our health business, by then it included a settlement of the equalization system from prior years, which was 17 million. So if we take out the hail storms and difference from the equalization of health, operational profit roughly remained at the same level.

The increase in life operating result was primarily driven by contribution of acquisitions is at 22 million and a higher amount from the realized gains reserve in our life business.

In the non-insurance business, we see that the acquisition and distribution become material, they contributed already for 10 million of the first half. In the results of bank and asset management, you will see the cost reflected due to the acquisition and integration of BNG, so there we are a little bit behind schedule.

So finalizing my part of the presentation before handing over to Chris, if I compare our performance with the targets, which we've set at the IPO for the medium-term, we are on schedule, we are in line or better than our targets and we are happy with that given the Dutch market circumstances. Now, we believe those medium-term targets are the right targets in this competitive and challenging market for the medium-term.

And having said that, Chris, let's hand over to you. You will discuss sort of the financial results, investment portfolio and especially capital, capital generation and our solvency position. Thanks.

Chris Figee {BIO 18815839 <GO>}

Very good, Jos, thank you. Ladies and gentlemen, Chris Figee speaking. Going to the financials, let me start on page number nine, the operating results. As you may recall, the definition of our operating result effectively is the full IFRS net result, but then excluding capital gains and excluding incidentals and results that do not relate to the core insurance business.

So the operating profit really is the all-inclusive profit of the insurance business, yet excluding capital gains or any results from methodology changes. You can see the bars for 2015 and 2016. If you look at the increase in the operating result from H1 to H1, 280 million to 292 million. In life, operating result underlying stable, but up due to acquisitions and due to finishing [ph] release from our capital gains reserve. In non-life, operating result down mainly due to the hail and water damage. And finally, in non-insurance segments, stable and up -- stable in some parts and up in distribution due to the acquisitions that we have made.

On the IFRS side, the full inclusive IFRS result, the deltas mainly originates with effect from [ph] last year, we made an additional provision to our real estate development business and we have substantive one-off capital gains in last year's half year numbers. This year our capital gains were less -- should I say less and we had a positive contribution from the release of an IAS 19 pension provision, due to the fact that we reduced significantly our inflation commitments to our retired employees.

So effectively, IFRS profit down, virtually stable, where delta in capital gains balanced off a delta from IAS19 minus last year's addition to the real estate development provision, operating result up 12 million from 280 to 292, actually mostly in the Life segment. In non-life, we were affected by the hail and water damage.

Let me walk you through each of the different business lines when I go to page number 10, on non-life. An absolute result, operating result of 62 million, as we understand it's probably still the highest absolute number in non-life profit in the country, down 25 million due to the hail and water damage. We had significant storms at the end of June. One of our reinsurance partners told me, this was the most intense, as they call convective hail and water storm on record with precipitation -- 20 millimeters of precipitation in the build [ph] in 10 minutes; and the highest level of humidity ever measured in our country that cost about 25 million after reinsurance. However, after absorbing a 25 million net loss from net claims, our combined ratio in property & casualty still at 99%. And excluding those storms, combined ratio in P&C of 94.6%. So still underlying very strong.

If you look at the claims ratios, they actually hover around 63% in the last half year, actually were coming down before the storm, if you normalize before the storm were still around the 60% to 63% claims ratio in P&C, so a very healthy underlying property & casualty portfolio. In disability, a combined operating ratio of 90%, again, still in the low 90s across all the lines, very stable and strong performance and a combined ratio of 90% is commensurate to a very substantive and attractive ROE in this business.

It's our understanding that in both disability and P&C, you can see the volumes are up and we feel quite proud that probably the combination of an underlying strong combined operating ratio and an increase in volumes, which is a sign of very healthy underlying market position.

In our health business, results declined by 17 million, mainly due to the fact that last year we had a bigger contribution from the National Health Equalization System that contribution was down about 17 million versus last year. It's our understanding that across the board, across all the health insurance companies, contributions from the Health Equalization System are down. Secondly, on a full-year basis, this effect may wash out because we tend to give that to customers what we receive back from the equalization system. So less received in H1 is less giving back in H2. So over the full-year, this impact will be much less.

All-in-all, we are very proud of a Non-life segment, we have an absolute return of 62 million, absorption of a significant storm and a combined operating ratio for the entire Non-life segment of 96 and online [ph] combined ratio in the 94%. So a very strong continued delivery on the non-life side.

If you allow me to move to page number 11, looking at our Life segment, life, as you may recall, contains individual life, pensions and funeral. Results up from 222 million to 273 million. Two broad causes for the increase, one is the contribution from the acquisitions, AXENT and De Eendragt that we acquired last year added about 22 million to the operating result; and the remainder is filled by additional release from a capital gains reserve, which is a combination of capital gains reserve release, release in gains on swaptions minus additional amortization of swaptions premium and slightly lower direct investment yields.

So net-net, a positive contribution from release on capital gains, as a function of our shadow accounting. So all-in-all, life business up, half of the increase by acquisitions; and half by additional releases from the capital gains reserve.

If you further look at the individual life business, as Jos said, we manage it for cost and lapses. I think on cost, we are investing in the migration skills of our systems with a number of important migrations ahead of us in the next six to nine months. Those will and are like to deliver additional cost savings.

Secondly, we invest or manage for low lapses. We saw small uptick in lapses, mainly due to the fact that people are increasingly moving house in the Netherlands, paying down their mortgages and also lapsing the corresponding life coverage products. A small increase in lapses due to the increased moving in housing behavior in the country.

In funeral, we acquired last year AXENT, this year we added the buyout of the NIVO portfolio. Together, the funeral businesses are approaching 5 billion liabilities. So busy life and funeral together, funeral is our quarter of the entire life and funeral business; and the acquisitions are adding 40 million of premiums; and about 2 billion of AUM into our funeral business. And integration of AXENT and NIVO is growing at or in some areas, even ahead of plan.

In pensions business, as Jos said, our focus is on defined contribution. We've had a significant growth in our defined contribution portfolio in two sources. First of all, in the SME space, where we find it is very attractive to our clients, who are -- those are smaller tickets, but very sticky tickets. The retention ratio in a defined contribution, this is about really 99% as an EPC business. Second contribution is from the De Eendragt portfolio that we acquired last year, where we are migrating clients from DB to DC. And as Jos said, the up-market, large corporate market in DC still characterized by pretty heavy price competition that's why we're focusing on the less price-sensitive SME and mid-corp into our client base.

Finally, we note that actually pricing in the DNB [ph] market is improving. We're not very active in DB, but we're seeing less price competition in that field. And actually, the old-fashioned ZANB [ph] measured that very few people actually use, we don't communicate because it's very old-fashioned measure, but we were able to write new business at a positive ZANB (inaudible) in the DB space. We do apply to a lot of DB. We retain clients. We extend contracts but that can be done in today's market with a positive than ZANB due to the reduction in competition in that field. So overall very strong performance also in the life, pension and funeral business.

Page number 12, non-insurance consists of in the operating side, banking asset management, distribution, holding and other. Banking asset management result, operating result down from five to zero especially because we invest in third-party asset management skills. So we're building up the team. We're investing in our franchise.

We added BNG Asset Management to the Group, adding almost 5 billion of AUM, but again this is cost goes ahead of the benefits we're investing today and the benefits are planned to come once the APF approval has been received and once the pension fund asset become really approachable to the insurance committee, which is kind of the function at the launch of the APF markets.

In distribution, results up from 4 million to 10 million mainly because the acquisition of Boval. We're actually very pleased with the acquisition we made in the last years. We've acquired Van Kampen Groep and Boval, which are two service providers in respect of the P&C and distribution. And this year we added SuperGarant, which is a specialist intermediary business in disability in the supermarkets and retail segment. And we added Corins, which is an underwriter/broker in the mid-corp segment.

With that our Distribution segment now really has body and we believe it's moving towards a full year run rate earnings around 20 million once this is included in for a full year basis. So gradually the Distribution segment is getting real body, real cloud has meaningful size in the Group. Holding and other results effectively stable.

In non-core businesses, mostly around real estate development, as you may recall, we split that business into two: real estate development business, which is in run-off, which is the completion of a large retail project. In the last years, we made substantive contributions to the provision for this business. They were no longer repeated. The 5 million is just the accrual of the NP REIT's [ph] provision. And discontinued operations, we closed the sale on -- in April. I think it was in the 26 of April, the closed sale of a substantive set of projects of the remaining holdings in that for-sale part, mainly the land banks, property development land banks, sales purchase ongoing and we revalue them adding 12 million to the IFRS financial result.

So in summary, non-insurance, banking and asset management, investing before benefits, distribution, the acquisition and investments are paying off and start providing real meaningful contribution to the bottom line. In non-core, real estate development effectively stable or preparing and continuing the sales process with commensurate valuations.

That turns me to the investment portfolio, which is on the pages 14, 15 and 16. I'll not go to all the details in this -- in the portfolio, I'll give you a few highlights. At ASR, we run a (inaudible) investment portfolio. Luckily, our solvency and our capital enable us to run effective investment portfolio, it adds value and adds to the bottom line of the Group. However, the market risk component and we'll talk about it later, market risk is still less than 50% of our total risk. So the core of our business is underwriting, but it's supplemented with an attractive investment portfolio that makes up still less than 50% of our total risk. The total assets of the Group, and I'm on page 14 went up from 53 to 59, partially due to revaluations, partially due to the acquisition of BNG, and partially due to decline of the life book, where actually asset gradually flow out. The quality of the book, the riskness went down a bit, you can see in the bottom right that the share of fixed-income assets and within fixed income, the share of high-quality assets AAA and AA moved up to about 63%; the 63% of our fixed-income portfolio is AA or better.

Page 15 talks about full details on our fixed-income portfolio. You can see, we added about 300 million in mortgages in our fixed income portfolio. Notably, the actual credit losses on our mortgage because they are less than 1 basis points. So the quality of our mortgage book still very high. Both the government guaranteed and non-government guaranteed with (inaudible) less than 1 basis point. And also, we made some adjustments in our portfolio in the first half and I'll talk about it later. Reduced some equities, reduced some credits and we expanded our interest rate hedge, but I'll talk more about that in a few minutes.

Finally, on page 16, the equities and real estate portfolio. We continue to believe that the real estate it is in our definition is a core holding of our business. I've seen some analyst and some market participant think that we have a really aggressive real estate portfolio. Please note that of the 2.8 billion, 1.2 billion is in land and 700 million is in housing; so two-thirds of our real estate portfolio is in land and in housing, both very stable, very sought-after high demand yielding assets. So we believe that the quality of our real estate portfolio is very, very high.

Second point to note, our offices do contain offices for own use. We have consolidated offices -- our own office into one building that means that the vacancy and so the portfolio went up because we actually move people, our own offices to one of our -- to our central building. Mind you, the yield of the vacancies for half year is still at 4.2%, it's a very attractive portfolio. And just to be sure, our land portfolio is the agricultural land not development land, not development properties, it's agricultural land aimed at renting it out to farmers and getting farmers yields.

So all-in-all, we believe we have an attractive yielding investment portfolio in which we actually decreased the risk somewhat in the first half of the year by moving out of equities, moving back into some of the severance (inaudible) served as well, and we have an effective real estate portfolio, which is predominately an yielding land and in housing and the offices consist of a significant part of offices for our own use.

That brings me then to solvency and capital; and I'm moving towards page number 18. As you may be aware, in solvency, we always talk about stock and we used to talk about flow and both in these day and age should be sufficient, it should be (inaudible) from. In terms of stock, our Group solvency ratio remains strong at 191% using the standard model. We run our capital base using the standard model. We have ECAP model, we have an internal ECAP model that stand as totally substantially above 200%, but we manage our capital, we manage our dividend base using the standard model at 191%. And all of the solvency ratios of the operating companies exceed the risk appetite statement will exceed our risk limits.

In terms of flow, in terms of how much capital do we create, continued organic solvency creation of 159 million, pretty much in line with the guidance and expectation raised during the IPO.

If you allow me to page 19, development of capital, I would say call me old-fashioned, but I'd like to look at multiple type of book values. In this chart you can see the IFRS equity, the SCR own funds, and our ECAP own funds. SCR equity continues to go up. In the first half of the year, the headline IFRS equity declined from 4.2 billion to 4.0 billion that really is an accounting phenomenon from an IAS19 accounting of our pension exposure. If you correct for that which is really an accounting phenomenon, excluding it the IAS 19 provision would have been stable, it's called actuarial gains and losses. Our IFRS equity would have been at 4.5 billion or increased by about 5 percentage points. So underlying an increase in IFRS equity masked by actuarial gains and losses, which really is the accounting treatment of our pension obligations. SCR own funds and ECAP own funds both continue to increase with an except, the ECAP ratio is solidly and safely above 200%. I remind you the difference between ECAP and SCR are that in ECAP, we have a more precise, more granular measurement of market risk. We use some of our own models in market risk. And especially on the LAC DT, where we believe some of the SCR assumptions are fairly uneconomic, we assume a full fiscal unity for the Group, whereas in the SCR world you're made to believe that fiscal unity does not exist or is in practice of course, it does and we are correct with it in our ECAP modeling.

Page 20 shows the development of the actual solvency figures, the numerator and the denominator. Our own funds, eligible own funds of 6.5 billion, required capital of 3.4. If you divide one by the other, you get the 191% solvency ratio that we've communicated. On the own funds, some key data point factoids [ph] on the right of the page.

Our Tier 1 capital is 85% of total own funds. Tier 1 capital alone represents 162% of SCR. If we just add Tier 1, our solvency II ratio would have been 162% already in our safe management zone. So any doubt on tiering not in this building and significant further headroom available, Tier 1 with room for issue qualifying capital for 1.1 billion; tier 2 room to issue 700 million of qualifying capital if we wanted to. We do not contain Tier 3 capital.

On the required capital basis that market risk is still less than 50% of our pre-diversification risk. So any claims that we have in excessively risky book, no we do not. We have a reasonable and attractive market book, market risk book, but the heart of our risk is underwriting risk. Where were the deltas in solvency. Well in own funds we'll talk about it later mostly profit creation. On SCR, we saw an increase in life risk, mostly because of lower interest rates.

Lower rates increase the NPV of -- for example, longevity risk, so the deltas were in life risk, mostly interest rate affect. The deltas were in counterparty risk for two reasons. One is we are loan collateral in a -- in our (inaudible) book being loan collateral increases counterparty risks to banks, so counterparty risk went up. Secondly, we invested into our mortgage book and with the increase in mortgages also our counterparty risk went up.

So the two source of increases in risk that the dominant source of increase in SCR were life risk, mostly the NPV of longevity risk and counterparty risk from collateral against banks and from the mortgage book. But again, very much in line with the 191 solvency ratio; and again with the 1.1 billion Tier 1 or 700 in Tier 2, we have headroom to receive further capital if we wanted to. And for the IAS specialists out there, our LAT liability adequacy test numbers were still very positive with a positive LAT surplus in life and a positive LAT surplus in non-life.

Page 22 -- 21 talks about our sensitivities. As you can see here, we've got a management range, where we strive to run the business at a solvency level, solidly and safely and consistently above 160 that's our management level and 191% already on the upper end that pretty stable and solid into -- in that range.

You can see sensitivities on the UFR, a lot has been talked about it, lot has been said about it, lot has been asked about it. We are aware, there is an EIOPA consultation paper around that defines a preliminary UFR target 3.7. There are number of discussions.

As you know, our own regulator has sent a letter -- published a letter saying that they would recommend the EIOPA to move to a long-term moving average UFR, which effectively will be around the 3.2 mark depending on where the rates are. So therefore we disclose our sensitivity to those numbers, which we think that to range in which the UFR discussion in the industry at (inaudible) EIOPA takes place. So the 3.2 to 3.7 is probably the range, as relatively discussed. If UFR would drop to 3.7, which is a 50 bps drop, our solvency II ratio will drop to around 179. If UFR would drop to 3.2. So a full percentage point deduction, our solvency II will be around the 166% mark. So in the range of discussions with EIOPA, with ECOFIN and the industry, any of those drops will still allow us to stay safely in the 160% plus, the management range. By the way, it is all still excluding our mass lapse reinsurance contract that was signed in July.

You can see also the development on the VA. Roughly speaking, one VA point is one point of solvency. The volatility adjuster for 30th of June was 18 bps, down from 22. So from 22 to 18, we reduced VA by four points, which affected us roughly also by taking out four points of our solvency, reason being that the VA portfolio contains much more peripheral Italian and Spanish and Portuguese and Greece government debt that we have in our portfolio. And actually, we feel comfortable, we have our own asset mix. We don't try and want to mimic the volatility adjuster. We follow our own diversification, which means that if spreads contract, especially if peripheral spreads contract that causes the VA to decline relative to our portfolio.

And cost of solvency, similarly, if spreads blow out, if there is a safe haven scenario, the VA tends to protect us. Roughly speaking, one point VA is one point in solvency. That's why, if credit spreads widen and the VA spread widen, they tend to be supported to us. You can see also the sensitivity against real estate and into equities, those are really manageable numbers.

And finally, on the right hand side, you can see the interest rate sensitivity, please note, in the last half year, we increased our interest rate hedge and I'll talk about it a bit more in a minute. We lengthened the duration of our portfolio that actually changed the sign of our sensitivity against interest rate increase. So now it's minus 2 when interest rates go up by 100 bps, and plus 5, if interest rates go down by 100 bps. And the change in sign really is the function of the adjustment we took through our hedging -- hedging portfolio.

Talking about interest rate hedging, page 22 gives additional disclosure in our interest rate sensitivity in our hedging portfolio. We -- there we follow a dynamic hedging program. Basically, we take into account the actual cash flows of the business bucketed by durations and we take into account the SCR as is. And we'd like to stabilize the SCR as is, as much as possible, but also present the SCR excluding, for example, UFR effects, excluding all our measures, other than what we call univestable areas not to drop too much. We look at the probability of developments on the various scenarios.

We (inaudible) when that -- when interest rates fall, we increased our hedges, we added about 900 million notional receiver swaptions to our book to extend the money duration of our business, which means we're actually long duration versus the official SCR curve, we're substantially the long duration, which means that if interest rates fall, our solvency goes up; if interest rates would increase, our solvency goes down, which is a function of the fact that we are long durations versus the SCR curve.

If you look at the implied UFR, we did some analysis on the implied UFR, at what UFR level would we be fully matched that will be around the EIOPA target level. That's not a goal in itself, but as they start to outcome [ph] our hedging policy, where we have cash flows, where we have durations, where we have solvency excluding UFR effect as well. And as a result, when rates fell in the last half year, we added interest rate sensitivity and increased the duration, which also served us very, very well.

Page 23 talks about our response to market developments. In the first half of the year, we saw interest rates going down; we saw credit spreads going down and we saw volatility going up. Together that led to, in our view a reduced risk tolerance for the Group believe that was in the environment in which you -- we wanted to reduce some of our risk exposure. So we reduced some equities, we reduced some credits, you shouldn't think too much of it, but there was a further optimization in equities and credits taking out some risk and we increase the money duration mostly through receiver swaps and swaptions to be flat or reduce risk tolerance, which again is a function of rates, of spreads and of course liability.

After the 30th of June, we signed a mass lapse reinsurance contract, which is not yet in the figures, simply which was signed after half year. But pro forma it will add about 5 points of solvency to our SCR ratio. A bit of (inaudible), mass lapse is the sixth largest risk category in our books, relatively heavily charged and we signed a reinsurance contract, which actually is an actual risk transfer, it is not an arbitrage deal, it's an actual risk transfer with actual reinsurance counterparties.

So we made sure that we actually signed a proper one of that old-fashioned reinsurance contract not with some Banana Re [ph] from Bermuda, but with like some old-fashioned classical reinsurance counterparties. And I must say credits to Guy Carpenter and to RGA and Unigreen [ph] for helping us structure this deal. Effectively adding pro forma 5 percentage points of solvency it's UFR independent solvency, for those of you who would love to add it to the notes. 5 points of additional solvency after the half-year figures.

As a result of all this, we believe we have a very strong balance sheet given market uncertainties, given political uncertainties, given low rates, we believe this is the time to build a fortress balance sheet, this is the time to build strategic flexibility; and with the combination of optimization of market risk, increased interest rate hedging and additional reinsurance programs provided with the fortress balance sheet that you'd be looking for provided with strategic flexibility that allows us to optimize our position in the current very uncertain world.

Page 24 is the page that most of you have been waiting for. We like -- you all will be holding your breath to talk about organic capital creation, so I will do that just right now. At the end of last year, we noted reported 185 percentage point of solvency with a moderning bandwidth of about 10%. We went through some of the day-one adjustments that saved us 5 percentage points from that solvency figure for the -- from the 31st December to the 1st of Jan, we saved about 5 percentage points from our solvency today-one adjustments.

(inaudible) first of all in the disability space, where we have a future management action in our solvency, we added some additional prudency into the assumptions on how, if and when to apply that management action. So additional prudency in the -- in the future management action in disability and we made adjustment to the calculation of interest rate and spread risk.

Both of these metrics or adjustments affected relatively the required capital and to a smaller extent, the available capital, so really an increase in the required capital gives us a starting solvency level of 180. Actually you get to the 180 by dividing 6,076 by 3,374, so in our day-one, 6,076 divided by 3,374 gives you the 180% starting solvency. Then we added organic (inaudible) to it and marked the operational developments for a total increase of 11 points.

Now, we believe it's important to disclose what is inside organic capital creation. There is one number and the one number is relevant and the one number is what we see about, it's important to understand what's in there. In our view, there are three buckets; business and operational capital creation, capital release for a net decline of the book; and finally, the technical component that represent the interactions between stock and flow.

Key to show is that we generate capital from our business, from operations that we run not just from the run off of the back books. We are a capital generation story, a capital generation business supplemented with capital release from the back book. So we have got the cake, which is the operating capital release; and the icing, which is the run off of the back book. But both of these functions add capital; and finally there are technical movements between stock and flow.

Now, let me start with the letter. The minus 3, 2.9% to be precise, it includes the UFR drag, as you may be aware. If interest rates fall, the UFR in fact goes up, but gradually it declines over time. The UFR drag was about 75 million in the first half year leaving 22 million for decline of amortization of the transitional rule.

Please note that some insurance companies exclude transitional rule in defining organically created capital or if we can make our own choices, we've included, but if you want to have a like-for-like, peer-for-peer comparison, the 22 million will need to be added back to our 159, getting to a total of 180. Of course, the UFR drag is depending on the interest rate, but effectively it's outside our control. It is what happens, so that's why we find it important to show it to you. If rates would fall, yes, stock would go up, flow will go down by increasing UFR drag. If the EIOPA would lower the UFR, you'd see the opposite, a lowering of the official UFR by EIOPA would reduce stock and thereby increase the resulting flow. We believe there's no point in calculating all sorts of sensitivities, it is more or less a given.

Some of you are going to ask us about the amortization of the UFR book, so let me anticipate that question. The UFR applies our life, pensions and funeral book. Our life and pensions business is tilted towards next 10 years, where the heaviest of ways of the UFR drag takes place, but our funeral book has a much longer exposure.

So is there a wait --is there an average maturity of our life and pensions book? There is one, but it's actually meaningless to calculate because it's driven by life and pensions on the one end and funeral on the other hand. We believe we will see a significant amortization of UFR in the next 10 to 20 years, but there will be UFR effect with very much longer duration because of our funeral book. And please note the way we run our funeral business, we do write new policies, we do acquire businesses, we will add the UFR benefits to our portfolio even if they stay mature over time.

One step to the left, the net release of capital. This is a release of SCR capital, release of risk margin net of new business stream. Roughly speaking, SCR minus new business range, the release of required capital minus new business range is about 1.6%. The release of the risk margin is about 1.9%, together around the 3.5% mark, additional capital generation from running off our individual life books.

And then finally to the left, the business generation, the operation generation of capital is around 4.1%. In there is the assumption that our investments yield the long-term investment margin. You may recall, for those of you, who have participated in our IPO stories, the long-term investment margin assumes equity it generates 3% above the solvency II curve; real estate about 2%; credits about 30 basis point -- 50 basis points; non-core sovereigns 30 bps moves around 80 bps, if you throw that in the mix, we give a long-term investment margin, which we guided towards up 50 to 60 basis points. It has been a bit higher in the first half year giving us a significant long-term investment margin that's phased into the operational capital generation.

Any additional return over and above that long-term investment margin is reflected in market and operational results. But numbers that I show to you together give us 4.7% of capital, 160 million on a net basis, 180 million if you exclude transitional and 260 million if you exclude transitional and the UFR drag. But again very much driven by both organic business configuration, plus the release of capital from our life business.

Some of you are going to ask me about the conversion factor, so let me answer the question also before you can actually ask it. We've guided to you that the conversion factor in capital tend to be about 75% to 85% range. In the first half -- you really need to wait for the full year to run this number because the full year number that is relatively relevant, but in the first half year, it was in line with about a 75% conversion ratio. And it was 75% because part of the increase is the life operating profit was from release of the capital gains reserve.

So if you take the operating profit after-tax and you compare it to the 160 million capital generation -- organic capital generation, the conversion ratio was about 74%, 75%, slightly lower than the 80% because in life operating profit, there was a release of the capital gains -- capital gains reserve.

A few words about the market and operational developments and again this is market development and business development over and above, what was in the organic operational capital creation. The six actually is a positive number for market and a small negative from business. In markets, we have the positive impact from our hedging program. We had a positive impact from returns over and above the long-term investment margin, minus a four points drag from a decreasing volatility adjuster that was a significantly positive number and a small reduction from the business due to delta in life cost, what we took into account the investment cost and migration cost in life and where we took into account, in fact in the mortgage business, the moving behavior, the house moving behavior in Netherlands goes up. People are buying and selling houses again, they are moving again; and therefore, prepayments are up in the mortgage side.

So in summary, market is significant plus, which is returns over and above the LTM minus four point VA, minus business changes mostly in the mortgage book, net-net a 6% addition over and above the organic capital creation. At the end of the day, we end up with a 191% solvency II standard model level, up 11% versus last year.

I once said last year. In terms of (inaudible) look at the capital the way Winnie the Pooh looks at honey; I think you guys still do that, but in today's day and age, it was bit like Snow White looking at the House of Seven Dwarfs looking for a place you can find shelter and looking for a place you can find safety. Well at 191, I'm looking at Seven Dwarfs are on the table, we have a very safe and stable building here.

Finally, let's move to our balance sheet, page 25, balance sheet management. You can see that solvency ratios at all our insurance at least above the target solvency levels and enabling us to upstream capital. We paid 170 million of cash to -- of dividends to the NLFI. We remitted 190 million to the growth of the holding company predominantly from the life business. So the cash remittance exceeded the dividend paid and exceeded capital generation. And we are on track with the cash at the holding at 181 to move towards the 350 million year-end cash target for the Group.

Also one thing to note is that we are in the process of integrating and merging the various legal entities that we have. We have received or hopeful to receive the official approvals to merge our non-life entities into one entity and all our life entities into one. So that allowed even more flexibility and freedom with regards to capital management. But please note that on a consolidated basis, all our operating entities exceed our solvency and ECAP ratio and therefore able to upstream cash to the holding.

Finally, before I hand back to Jos, our risk indicators, you can see, our claim, we have a fortress balance sheet, financial leverage about 26%, interest coverage around 13 to 14 times. If you do this number not just on the operating basis, on an IFRS basis, it would be even higher. Rating confirmed at single A neutral. AA -- sorry double leverage up a bit to 108.7, but it was really due to the accounting phenomenon, the delta in actuarial gains and losses. If you would keep the actuarial gains and losses element in our IFRS equities table [ph], our double leverage would actually have fallen to 99%. So all in all, we continue to have a very strong and very stable balance sheet, a fortress balance sheet allowing us to stand and to provide shelter in volatile -- volatile times.

With that, I end my part on the financials; and give the floor back to Jos.

Jos Baeten {BIO 2036695 <GO>}

Thanks, Snow White. To conclude this presentation, I think ASR delivered very strong results over the first half year with a capital stock of 191 calculated based on the standard model with a potential uplift of 5% due to the mass lapse contract. We have a conservative calculated capital flow of 159, 4.7 of the SCR, due to our strong operational results and disciplined execution of the strategy. We will be able to grow -- we've been able to grow our top line profitably over the last few years. And all things being equal for the remainder of the year, we are confident that we will be able to deliver on targets.

Having said that, I'll hand back to the operator and he will open the floor for Q&A.

Questions And Answers

Operator

Ladies and gentlemen, we will now start the Q&A session. (Operator Instructions) First question comes from the line of Mr. Ashik Musaddi of JP Morgan. Your line is open.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah. Hi, good morning. Ashik Musaddi from JP Morgan. Just got couple of questions. Can you give us some sense about the additional UFR drag that can happen because of year-to-date interest rate decline. I'm not sure because I'm not sure if your numbers are based on the organic capital generation and UFR drag is based on the beginning of the year assumptions or the current assumption because for other companies this has -- this number has moved quite a lot? So that's the first question.

The second question is, can you give us some sense about -- if I look at your operating capital generation, it looks at around say, 200 million, which is operating capital generation net of UFR and adding risk margin. So is that -- what is the main driver of dividend or is IFRS is the sole driver of dividend, so how should we think about that?

And last one is, it looks like your capital is running off at around, say, 4% which is SCR release. So will that impact life earnings as well or do you have other measures such as just say M&A to counter that? Thank you.

A - Jos Baeten {BIO 2036695 <GO>}

Chris?

A - Chris Figee {BIO 18815839 <GO>}

Yes. Ashik, very good. Thank you very much. The UFR drag, I mean it's our understanding or estimate that we run the UFR drag based on the beginning of year numbers, I'll take into account the developments during the year. So at current level, at today's rates, yeah the UFR can go up a bit. I think it's actually not relevant to continue to calculate the UFR drag every single day because the interest rates move. As Jos said at today's rates, at today's number, we feel confident that we can and we'll deliver on the guidance we have given at the IPO in terms of total capital generation.

When it comes to the underlying capital generation of the business look there is various components, right, there is the component of the business capital creation, which is about 4%. There is a component on SCR release and risk margin release both in the 2% mark more or less; and then there is a UFR drag and the transitional rule.

We can all slice and dice however we want it to. I tend to look at the fact that both -- if you look at the business that we have, combined ratio that we -- that we show, the business capital creation, the 4% is actually pretty strong and pretty stable. If you look at the underlying combined ratios that we have delivered for quite some years, they tend to be good. There are some downward pressure of course from low yields, but again that pretty strong.

And please note that the LTM assumptions in that number are pretty conservative. So there has always been a spillover from organic capital creation operational into market development. So if yields drop, then maybe a decline actually in operational generation, but the market component will actually increase. So it will show up in a delta solvency, it will just show up in a different -- different bucket.

Secondly, the net release of capital is pretty stable. The life insurance book will inevitably decline that will continue to add capital and then technical movements are again, as a function of interest rates, they may increase, they may also decrease depending on where rates are. Net-net we believe the guidance we've given at IPO and we're at a consensus, this is something we can actually -- we feel very comfortable in delivering that going forward. So I look at the total number, whereas each -- the -- first the 4 and the 4 are both pretty stable actually especially if you combine to the fact that some of the forward operational will spill over into market developments.

In terms of dividends, we've -- and our official dividend policy is we link dividends to our IFRS results. We've done that because that's actually an audited and more stable number. At this stage, current industry practice to link dividends to operating result; and we stuck to that. If there is more capital available of course and we have sufficient capital we find ways to share it with our shareholders, but at this point in time we believe it's appropriate to link dividends to the operating result.

A - Jos Baeten {BIO 2036695 <GO>}

And our official policy is 45 -- between 45% and 55% of the operational result. We will pay a cash dividend as from an SCR of EUR140. And we already last quarter -- at IPO communicated that we are going to pay EUR175 of dividend over the full-year 2016.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Thank you. That's very clear. Just a follow-up on the beginning question that I had with respect to UFR. I mean, the only reason I'm trying to get some sense around that is because in your prospectus you somewhere mentioned that ex-UFR for 100 basis point decline, your own funds go down by, say, 1.7 billion. That is Solvency I basis. But I think own funds for Solvency I and Solvency II is that -- not that materially different for Dutch companies.

I mean, that's a big number. So based on that understanding, I guess, for first half interest rate decline, the UFR benefit must have increased quite a lot, I mean, 700, 800, maybe more. And that could lead to a significant erosion of your -- the third bucket, which you have shown i.e. instead of 2 points of UFR drag, it could be, say, 4 points. So that's the reason I'm just trying to get a sense, i.e. if interest rate don't go up, what would that number look like?

Because ultimately, your operational capital generation, the first bucket, is not changing, the second bucket is not changing, but the third bucket can be a chunky number. That's the reason. Thank you.

A - Chris Figee {BIO 18815839 <GO>}

Yeah, let's say, if interest rates don't go up or go down, of course, the UFR rate goes down. But again that -- probably those would be compensated by the latter bucket, which is in market and operational improvements.

So that's why the total delta in solvency, I don't think, will change that much from any interest rate changes.

And secondly, as I said, we reiterate that fact that we believe there is sufficient room in the first two buckets to absorb any deltas in the UFR drag over time at current rates.

Q - Ashik Musaddi {BIO 15847584 <GO>}

That's great. Thank you. Very clear.

Operator

Next question comes from the line of Mr. Albert Ploegh of ING Bank. Your line is open.

Q - Albert Ploegh {BIO 3151309 <GO>}

Yes, good morning, sir. Good afternoon all. A few questions from my end. Maybe to come back to the mass lapse reinsurance contract, can you basically give a little bit more background to two different sections, what the exact reason was.

Because, maybe I read this wrong, but I guess that a lot of folks, let's say, kind of guarantees you have on different insurance products are actually in the money, so to speak, with the current low yield environment, so if client lapses, it could actually release capital. So I'm a bit confused, what the reason behind this reinsurance contract is.

And then the second question is on the ongoing shift from defined benefit to defined contribution. Now, you see that basically continuing to happen, maybe the pace in future can only -- will only increase. I mean, what kind of implications might that have, let's say, for your cost flexibility assumptions, is there some more risk of cost overruns?

I know, you already took some conservatism last year in your Solvency II numbers on that. And also, what does that mean for your release of SCR capital? Could that actually go more than we expect now?

And maybe I missed that in the comments already before, but on the closed book of individual life, can you maybe add what that actually contributed to the 159 million capital generation over the first half? Thank you.

A - Jos Baeten {BIO 2036695 <GO>}

Okay. Albert, thank you. On the mass lapse, in Solvency II, one has to hold capital against a mass lapse event. Actually, if Solvency II stipulates, you have to hold capital against an instantaneous lapse event where 40% of your life customers actually walk, like within a second instantaneously, which is a pretty half capital requirements.

Now, at this point, really the amount of lapse is relatively low, but I can think of -- I can imagine scenarios where there will be certain interest rate movements, where there will be certain news events where mass lapse shock could take place.

And we found that we could attractively reinsure ourselves against this risk, so that we're -- reinsurance, willing to take all this mass lapse risk from this. There is a certain attachment point and a certain detachment point. So we defined an area when we reinsured ourselves against such a mass lapse event and we actually transferred the risk against such a mass lapse moment -- mass lapse event.

And we did it because it released capital and released cost, relatively attractive cost, I think there was a real risk transfer with real insurance counterparties. But the cost of this capital was, for example, significantly below the cost of a hybrid bond.

And we felt that, one, it was a great opportunity to add capital to our business at a relatively attractive cost of capital. And secondly, we felt, given the political uncertainty, market uncertainty, this is the time to build, what I will call, a fortress balance sheet to increase the strategic flexibility of the Group. So if you want to use the opportunity, it's the time to do it. And I also think, when we have the IPO roadshows, many investors asked us how do you think about strengthening your balance sheet and various options and we said, look, we have had room for capital market instruments. We believe actually from a cost of capital perspective that reinsurance is a -- at this point a more attractive instrument than capital market instruments also because there's a lot of reinsurance capital out there, a lot of reinsurance capital available. So at the end of the day it was a tangible risk that you might say that's a [ph] significant charge in a Solvency II environment, but we will actually transfer the risk and pay a price that's a very attractive transaction to us.

Q - Albert Ploegh {BIO 3151309 <GO>}

Okay.

A - Jos Baeten {BIO 2036695 <GO>}

Albert on your question on our flexibility if the shift from DB to DC takes not place in the speed we expect or will be faster than we expect, our current and old DB platform already has been outsourced including 80 people. And there we already are on a more flexible cost base than we were in the past. And our new DC platform is a so-called software-as-a-service platform, which we -- which is run by a subsidiary of ABG, the Dutch pension company. So on the leaving side of DB and the income side of DC, we already have a high level of cost flexibility. So I think the speed of the transfer will not affect our ability to reach the cost objectives we have set ourselves.

Q - Albert Ploegh {BIO 3151309 <GO>}

Okay. And that's very clear.

Operator

Next question comes from the line of Mr. Matthias de Wit of KBC Securities. Your line is open.

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

Yes, good afternoon. First question is on slide 24 again. Just wonder how M&A and the derisking is captured in that slides, derisking presumably had an impact on the required capital. So just if you could quantify that and provide me with some comments on which bucket that derisking is captured, that would be helpful.

And then secondly, also on that slide, on the 6% market and operational developments impact, could you may be a bit more specific on how much the contribution was from investment returns above your assumptions; and on what assets are you currently outperforming your assumption? So I'm just trying to assess whether it is a recurring benefit at current spreads or whether it is more sort of sustainable in nature.

And then lastly, yeah, I had one other question on capital generation that is, if you could provide the breakdown between Q1 and Q2 from the -- for the organic capital generation, please? Thank you.

A - Chris Figee {BIO 18815839 <GO>}

Okay. Matthias, thank you very much. I think we could all save us paper and kind of going forward, we'll only produce page 24 in the next result. On the market operation -- on M&A, look, in the first half of the year, we didn't do any major M&A. There were some transactions that were closed after the 30th of June. The cumulative price that was really less than (inaudible) point. So that there is nothing numbers yet. If and when they come, you will not find them to be materially effective, so they were relatively small transactions.

In terms of contribution from historical transactions, they are either in the operational capital generation, in terms of the long-term returns are generated and to some extent in the operational and market and operational development as far as they deliver excessive returns. I don't have the split by acquisition, by bucket, but trust me in terms of new transactions nothing in these figures is small maybe 1 point -- less than 1 point in the coming half year. From existing deals, they were basically in the operational and the new market development (inaudible) block.

And what's in the market development, again, this is 6%, if you take into account that the VA was a negative 4 and the market was a positive and the business was a negative, so you're safe to assume that before VA development, the market was safely above 10% in terms of market performance over and above the LTM. I think it's mostly where do we outperform the LTM assumptions, mostly mortgages, credits and real estate that's really where the additional performance was over and above the market developments.

In terms of the derisking, there was also in this bucket, we sold about 300 million shares and 200 million notional credits. So that's still less than 10% of the total investment book. So, it did support the SCR ratio, but we shouldn't think too much of it. I mean, it wasn't the major driver, the largest driver in the market variances.

So, in summary market variances before the VA impact certainly above 10 driven by long-term investment returns in mortgages. Credits at real estate have outperformed LTM, plus a continuation from derisking in setting up some equities and some credits, just a small portion, then minus the business developments, which as I said in my presentation, really were all about changes in the mortgage assumptions and changing some of the temporary cost structures in life.

On your final question, do we provide breakdown of capital generation by quarter, no, really, we don't, because this is a number actually we look and track in the long run, except interest rates fluctuate over time, markets fluctuate over time and we're in long run business. I have no reason to believe that the Q1 was really that much different from Q2, but frankly speaking I don't have that number, we do it on a half-year basis.

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

Okay, that's clear. And maybe just one follow-up, if I may. Just to come back on Ashik's question, so your guidance for capital generation is still roughly in line with the guidance provided at the full-year results of around 9% organic capital generation, whereas spreads came down, rates dropped, you derisked a bit. So just wondering what's offsetting that. So is it M&A, is it the restatement, which might have a positive impact later on? So could you maybe help me understand that better please?

A - Chris Figee {BIO 18815839 <GO>}

Yeah. I think that number is still true. So what is different, I think, yes, recent spreads came down. At this point in time, our underwriting results are very strong in the first half year, excluding hail storms. So that's a very strong result. Although rates came down, we believe significant part of our portfolio, for example, our real estate portfolio, our mortgages portfolio continues to perform very well. We actually added some mortgages to our book.

After the 30th of June, after Brexit, we saw some real severe dislocations in the market, so we've re-risked a bit after 31st of June, where we found there was a value in some peripherals, some of the thick paper. So there was some small re-risking after Brexit in combination with the stickiness of yields in our real estate book. In combination with the solid underwriting results, we believe, we can continue with the 9%-ish type of guarantee. And finally, if rates fall we just work a bit harder.

And thirdly, the one thing where you may see some spillover is spillover between operational and market developments, because I find that if rates fall and return go up, sometimes they should -- excess return do show up in the market and operational variances. But all in all, we believe that the guidance given at the IPO still holds.

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

Very clear. Thanks a lot.

Operator

Next question comes from the line of Mr. Ron Heydenrijk of ABN Amro.

Q - Ron Heydenrijk {BIO 3653338 <GO>}

Hello. Good afternoon, gentlemen. A few questions. Firstly, on your combined ratios in the P&C business, you have a 94.6 excluding the June storms in P&C, which compares to the, I think, seem to remember 98% guided on the medium-term. What's the immediate outlook for that ratio? And Secondly, the same question basically for the disability combined ratio; 90.2% versus 95% medium-term guidance. The outlook there as well please?

Then secondly you give the sensitivity of your Solvency II to a UFR drop of 50 basis points and 100 basis points. Could you also give the reduction in UFR drag on the 50 basis points and 100 basis points as well please? And that's it for now. Thank you.

A - Chris Figee {BIO 18815839 <GO>}

Thanks, Ron. On the disability on P&C combined ratios, the medium-term target for disability is not 95, but 93, so with 92 we're pretty much on schedule. So the 93 stands, and we hopefully will do a bit better like we've done in the first half. The medium-term target for P&C is indeed 98. The hail storm we had is a realistic storm and we had to pay 25 million. So we just wanted to show what it would have been excluding hail to tell you something about the quality of the underlying book, but it is a real payment we had to do. So our medium-term, 98 for P&C stands. And we will have to work pretty hard because today P&C is 99.5, including the hail storm.

So both parts, as we've said, they are still the right targets to our opinion because we already took into account that we expected in the P&C business, as we have seen an increasing number of weather events over the last few years. We already took into account that it could happen in the P&C business. And as we expected, it has happened in the first half. So both are still solid rock targets, which we -- we'll be able to realize.

And the second question, Chris?

A - Jos Baeten {BIO 2036695 <GO>}

Yeah. On the UFR drag, what happens to the UFR drag if UFR goes down by 50 basis points? Well (inaudible), I don't have that number. If the UFR goes down, also the drag goes down. I -- we really obviously do not calculate that number because we could speculate what the UFR could become. We think it's relative to give the level of solvency stock for various UFR levels.

But then calculating the various levels of solvency flow, I mean, the flow of capital generation is to me is driven by business capital plus release of the book. And the final components to me are technical movements [ph] between stock and flow, which I have really no influence. I was just -- I'm a taker of the -- a receiver of the outcome not driver of the outcome. So (inaudible) I don't know, and I'm not going to find, not going to try to find out, I'll just see what the UFR actually has. I'm focusing on the business generation of capital and the effect of release of capital on the book.

Q - Ron Heydenrijk {BIO 3653338 <GO>}

Fair enough. Thank you.

Operator

Next question comes from the line of Mr. Benoit Petrarque of Kepler Cheuvreux. Your line is open.

Q - Benoit Petrarque {BIO 15997668 <GO>}

Yes, good afternoon, gentlemen. Three questions on my side. The first one will be on the bank and asset management earnings, which were quite low this quarter on zero. So you said that you have been invested [ph] in the business, I guess, on the asset management side. What type of outlook you have on the profitability for this segment because you -- the benefits from the investment in the APF will take some time. Well, that's my understanding of the market. So how we are going to kind of model the business line in the coming quarters? That will be the first question.

Second one will be on your kind of statement that you have a significant headroom to increase Tier 1, Tier 2. I kind of agree on the ratios, but then there will be some impact on the financial leverage, and you currently stand, I think, above 26%, not that far from a 30% target. So although you reconcile basically your leverage target to your statement that you have a significant room there to increase your Tier 1 and Tier 2?

And then the final question, sorry for that, it's just maybe on -- lack of knowledge on my side, but on the IAS 19 adjustment of 426 million on the equity, which took place in Q1 -- in H1, I think it mainly comes from lower discount rate, why do you -- I do not see any impact on the Solvency II ratio from this adjustment? Thank you very much.

A - Chris Figee {BIO 18815839 <GO>}

Very good. On the first question, on the bank and asset management segment, you can see the operating earnings are around zero. Actually, just slightly misleading because the financial earnings are positive. In this segment, you've got real estate asset management, capital market asset management with the bank. Actually, the bank has a positive IFRS income due to some capital gains on the bank's investment portfolio, but not a positive operating income. So that's why the financial income in the segment is actually better than the operating income.

Secondly, on real estate asset management, last year we had significant performance fee that was not in the same number this year. Thirdly, we've been building up a team, we've been adding the cost base of BNG to our business, we've been investing into new stock and investing into the APS [ph]. And, of course, it will take some time before the APS takes off.

When we IPOed our business, we said, in the long run, we're looking at a 7% to 10% earnings growth on this segment, using 2015 numbers as a starting point., we still believe that in the medium-term, the 7% to 10% growth is actually feasible. But it will fluctuate over time and, again, the cost will unfortunately come first and the benefits will come later. So we're awaiting the formal approval for the APS. And finally, if and when that happens, we'll see asset management going up.

So I would (inaudible) a long run development, where the actual benefits will come once the full APS permission has been received, and once the APS in the asset management business can actually go live. And secondly, please note, there is a positive IFRS income in the Bank, which does not show up in the operating income.

In terms of Tier 1, Tier 2, your question is absolutely right. We've got qualifying headroom for Tier 1 and Tier 2, yet we couldn't do all of that, we wouldn't go out and raise 2 billion of capital, because that would add 2 billion of leverage to it. We wanted to point out we have room to issue solvency qualifying capital. We've got about a good 5 points of additional headroom to issue leverage before we get to about this 30%. That would still be a significant issuance.

Would we go out tomorrow and issue qualifying hybrid capital? Probably not. But it's great to have the opportunity. But please note, for example, in 2019, we've got two older issues coming up for call, they have a 7% and 10% coupon respectively. And, of course, we can never give you commitments or can even give you this slightest guidance, whether we should call them or not. But at today's coupons and today's refinancing rates, that decision (inaudible) calling up is relatively easy to make. And you could, for example, be managing the scenario where you redeem 200 million of existing bonds with a 500 million of new bonds.

So there is various ways to optimize the capital structure, use the headroom that we have, but not use this -- not exceed our leverage targets. It's more of the fact we have Solvency II hybrid headroom.

Now, on IAS19, if you think about the impact, we had an actuarial gains and losses in our IFRS equity, which is in IFRS assumptions change, that does not directly impact solvency. So (inaudible)IAS -- IFRS phenomenon. It has to do with the fact that we, at ASR, are in a unique situation. We, ASR as an employer, reinsure our pension obligation with ASR as an insurer and the insurer then subsequently adopts shadow accounting.

Whilst we wrote the prospectus, we discovered we're actually the only insurance company in the world that has this phenomenon, where we actually have both our own clients and we apply shadow accounting with these two, volatility in the actuarial gains and losses in the Group.

So it is really an IFRS phenomenon, it is not a Solvency II effect. Solvency II really doesn't show up. So in market value balance sheet, you don't see this. It has to deal with the fact that actually the inter-company exposure is eliminated between the life business and the holding business. Yet, part of the exposures cannot be eliminated because they're in the shadow accounting methodology, especially to be very precise.

The interest rate hedge that the life business undertakes the hedge, the interest rate exposure from ASR as a client cannot be eliminated, because it's part of our shadow accounting treatment.

Now, we have all those writing pieces, these pieces about these subjects, but it's something that is really (Technical Difficulty) unsolvable IFRS issue that will lead to an IFRS volatility due to rate environment changes (Technical Difficulty) 426 actuarial loss in this quarter, it may go up, that actually might disappear in Solvency II, this doesn't show up at all.

So this the one thing where Solvency II actually is more clear than IFRS. So in essence, we actually are very pleased with this.

Q - Benoit Petrarque {BIO 15997668 <GO>}

Okay. Thank you very much.

Operator

Next question comes from the line of, hope I pronounce it well, Mr. Angel Kansagra of Barclays. Your line is open.

Q - Angel Kansagra {BIO 19712659 <GO>}

Hi, good afternoon all. I just have two questions. The first one is on the combined ratios on disability. I see that the commission ratio has fallen a lot to 9.5%. Is this something, which will continue so that we'll need to adjust the model or this was just one-off?

And the second one was on the operating ROE. You are running quite ahead of your target of up to 12% in the medium-term. Even excluding the impact of pension remeasurement, the ROE would be like around 13.7%. So what's your guidance for the full-year? Would you be running significantly ahead or do you see a fall in the ROE in line with your medium-term target? Thank you.

A - Jos Baeten {BIO 2036695 <GO>}

Thank you, Angel. On your first question, on the disability commissions, indeed they are a bit lower than they were last year. There are two reasons for that. The first one is, a change in the portfolio mix, traditional, there is a higher level of commission in individual that was even sometimes up to 20% that was lowered years ago to 17.5. And in the Group business, the average commission is somewhere around 10. And because the mix has changed a little bit, our portfolio slightly shifted a bit more to Group business. That was -- that's one reason why the commission is lower.

The second reason is, there is, a few years ago for individual business, there has been a ban on commission that didn't affect the existing portfolio, but it affects new business. So any new business, any real new business, new customers come in at a different commission percentage.

So over time, the commission percentage will be a bit lower than it used to be in the past that actually doesn't affect the results of our disability business because if advisors take out the commission by customers, the price will be a bit lower. So from our point of view, it doesn't affect the results of the business, but it only change the relationship between commission and premium. Is that clear?

Q - Angel Kansagra {BIO 19712659 <GO>}

Yeah. So what you're saying is that in absolute terms the commission might fall, but the ratio would not be impacted much?

A - Jos Baeten {BIO 2036695 <GO>}

The absolute business result will not be impacted over time by the fall of the commission rate -- of the commission ratio.

Q - Angel Kansagra {BIO 19712659 <GO>}

Okay.

A - Chris Figee {BIO 18815839 <GO>}

Angel, on your ROE question, just for the record for everybody. If you -- if the IAS 19 actuarial gains and losses would have been stable, at the same level at the end of last year, if you hold a pen and paper, the IFRS ROE would have been 19.8, operating ROE 13.4, financial leverage 24.3 and double leverage 99.4. So again, still very strong, very solid numbers. Indeed it exceeds our mid-term target of an ROE up to 12%. Is it time for us to change our earnings guidance? I think that's not the case. We stick to the guidance we've given at the IPO. But please note that the biggest threat to the ROE is the E, not the R, at this point in time, which is relatively speaking, a good problem to have.

Q - Angel Kansagra {BIO 19712659 <GO>}

Yeah, indeed. Thank you.

Operator

(Operator Instructions) Next question comes from the line of Mr. Bart Horsten of Kempen & Co. Your line is open.

Q - Bart Horsten {BIO 2390919 <GO>}

Yes, good afternoon, gentlemen. If I may, a few follow-up questions. On capital creation, you indicated that the net release of capital also included run off of your individual life book, and I was wondering, what part of the net release of capital was that in the 4%? And also, what can we expect going forward? Will this 4% be for longer period release of capital due to this run off?

My second question is just more a factual question on the Solvency ratios of your subsidiaries, so life and non-life, whether you could give us these numbers?

And I have a more generic question on your health insurance business. In Dutch Parliament, there's currently a discussion going on, whether health insurers would be able or would no longer be able to pay out dividends. And I was wondering if that would pass this law, what would that mean to ASR? Thank you.

A - Jos Baeten {BIO 2036695 <GO>}

Let me start with your last question. Actually, the debate is a reverse debate. It is currently forbidden to pay dividends and there is a discussion ongoing whether it should be allowed to pay dividends. So we will await the result of this discussion. And as we have said at IPO, we will not further add any capital to our health insurance business. The health insurance business has to earn its own right of existence, has to earn its own capital. And if they realize further capital growth, we will use it to invest in the health business.

And the reason we are still in health business is, it is connected to our disability business. We have one very successful product where we offered a combination of disability insurance and health insurance for employers, where they are able to insure their employers and to help employers to return to work, if they call in sick. That is from the viewpoint of the disability business is very attractive business.

Secondly, we sell a lot of health insurance through our digital brands and we have a high level of cross-sell between the health business and P&C business within that. So, for us, we don't have any capital, I think, by heart, 1.5% of our total capital is in the health insurance business currently, so it's very capitalized.

And the take-away from that business is that, that it provides us with growth in the disability and in the P&C business. So that's for your question, Bart, and I -- for the two other questions, I think Chris is ready to answer.

A - Chris Figee {BIO 18815839 <GO>}

Yeah, on the question of release of capital, what was the contribution from the individual life business and how stable is the 4%. The 4%, really the bulk of it was individual life. If you think about our life business, it has life, pensions and funeral.

Actually the funeral business continues to accrue liabilities. We invested in NIVO. And given the duration of the liability, it still tends to grow. So, it actually consumed a bit of capital because of the long duration of the assets and that the reduction, we think about the bulk of it, probably 80% to 90% is the run-off of the individual life book and the smallest portion really is the gradual decline of our defined benefit business, so it's really predominantly individual life.

Does it make the 4% stable? Probably yes. There will be some lumpiness over time, because business capital runs off as portfolios expire and we have chunks of portfolios that are written in the past, so you've got these (inaudible) annual layers, cohorts of businesses written in a certain year and that will expire in a certain year.

So in the long run, in the next foreseeable period, there is a reasonable assumption. But there may be some volatility as in some years a bigger chunk of the book, the cohort of policies expire, and in the second half the year, you have to wait for the reduction in cohort to expire.

So we really -- so they have chunkiness, when different cohorts, groups of policies expire. But on average, this is the number you can actually feel pretty comfortable at.

And in terms of, given the solvency ratios of our subsidiaries, at this point in time, we don't. Reason is, we are in the process of merging various individual subsidiaries, creating one ASR non-life business and one ASR life business.

We have already integrated De Eendragt, we're awaiting approval from AXENT, and we just received approval for our non-life businesses. So, given numbers on individual (inaudible) that are about to be merged, it doesn't make that much sense, because it's certain to be outdated at the moment you put them to paper.

So what we do today is that gives you the comfort and confirmation that the consolidated solvency level of these subsidiaries is sufficient and that we have been able to upstream significant amount of capital away to the holding, especially from our life business in the first half year.

Q - Bart Horsten {BIO 2390919 <GO>}

Okay, thanks. And maybe a follow-up on that. Is it -- does it deliver any additional capital synergies, both on the requirement or available funds with merging these separate entities?

A - Chris Figee {BIO 18815839 <GO>}

Well, basically what it does, it pushes diversification benefits from the holding into subsidiaries. So it makes them tangible, because diversification across legal entities happens at holding. Once you merge it, it happens into the legal entities. It does not mean that, we will go out upstream all these benefits immediately the day after the merger has taken place that will be not a responsible thing to do. Please note that, we have a policy of moving towards a certain amount of holding cash at Group, 350 million. And for the rest, we believe in giving and leaving the capital as much as possible inside the operating entities because that really where -- is where the money is made. And as long as our operating entities generate attractive returns on capital, we feel very comfortable leaving the capital -- cash in the subsidiaries. But at least it improve and enhances our flexibility when it comes to capital submission to the Group.

Q - Bart Horsten {BIO 2390919 <GO>}

Great. Thank you.

Operator

Ladies and gentlemen, if there are no more questions, no further questions, then I would like to hand over to Mr. Jos Baeten of ASR for the final remarks.

A - Jos Baeten {BIO 2036695 <GO>}

Well, everybody, thanks for joining us and being with us for almost two hours. ASR had an exciting first half year with our IPO at the 10th of June and all the preparations. After that, we felt Brexit, we have seen some severe hail storms. And despite all this, we've delivered upon the promises we've made at the IPO; a capital stock of 191 based on the standard model. We're meeting the target on the capital flow of 159 of the first half year; and we execute our strategy in a very disciplined way.

So we are very confident that also the second half of the year, everything being equal will be a successful year; and that ASR will be able to deliver its promises estimated at IPO. And hopefully, we will be able to report on that somewhere around the 22nd of February next year. Of course, in that period we will present our full-year figures of 2016.

I wish you all a good day. In the Netherlands, the sun is shining. Hopefully, you are somewhere, where the sun is shining too. And some of my colleagues promised me to look for a terrace and to drink a cool glass of beer on the results we've presented today. And Chris will be go back -- will go back to Snow White and join his Seven Dwarfs Children. Thanks everybody.

A - Chris Figee {BIO 18815839 <GO>}

Thank you.

Operator

Ladies and gentlemen, this will conclude today's presentation. Thank you for attending. You may now disconnect your phones; and we hope, you have a very nice day.