Q4 2016 Earnings Call

Company Participants

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

Other Participants

- Arjan van Veen, Analyst
- Ashik Musaddi, Analyst
- Bart Horsten, Analyst
- Benoît Pétrarque, Analyst
- Cor Kluis, Analyst
- Darshan Mistry, Analyst
- Farooq Hanif, Analyst
- Farquhar C. Murray, Analyst
- Gordon Aitken, Analyst
- Matthias de Wit, Analyst
- Michael van Wegen, Analyst
- Steven Haywood, Analyst
- William Hawkins, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. This is the operator speaking. Welcome to NN Group's Analyst Conference Call on its Fourth Quarter 2016 Results. The telephone lines will be in listen-only mode during the company's presentation. The lines will then be opened for a question-and-answer session.

Before handing this conference call over to Mr. Lard Friese, Chief Executive Officer of NN Group, let me first give the following statement on behalf of the company. Today's comments may include forward-looking statements, such as statements regarding future developments in NN Group's business, expectations for its future financial performance and any statement not involving any historical fact. Actual results may differ materially from those projected in any forward-looking statements.

Any forward-looking statements speak only as of the date they are made and NN Group assumes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information or for any other reason. Furthermore, nothing in today's comments constitutes an offer to sell or a solicitation of an offer to buy any securities.

Good morning, Mr. Friese. Over to you.

Eilard Friese

Hello, everybody, and thank you, operator. I will start off today's presentation by looking at the highlights of the fourth quarter results, the major events of past year, as well as the progress we are making to deliver on our strategic targets.

Delfin Rueda, our Chief Financial Officer, will then talk you through the financial details of the results at group level and for the individual operating segments as well as our capital position. I will conclude the presentation with a wrap-up after which, we will open the call for Q&A.

We also have Jan-Hendrik Erasmus, our Chief Risk Officer with us to answer your questions. So, let's turn to the slide of the highlights, slide number 3.

NN Group's operating result of the ongoing business for the fourth quarter of 2016 was €282 million. This is an increase of 13% compared with the same quarter of 2015, with most segments reporting higher earnings. On balance, the Netherlands units achieved further cost savings in the fourth quarter, bringing the expense base down to €761 million.

Our insurance businesses reported a 12% increase in total new sales at constant currencies compared with the fourth quarter of 2015. This was mainly driven by the successful launch of new products. The value of new business increased 6% on a full-year basis despite lower interest rates.

It was another strong quarter for NN Bank with significant production of new mortgages and healthy inflows of savings. And our asset manager, NN Investment Partners, again attracted net inflows of third-party assets.

We continue to see volatility in the results of our Non-Life business, and this means that we are not yet making sufficient progress to lower our combined ratio towards our target. We continue to implement a range of measures with the aim of turning this around.

Our balance sheet and capital position remain strong. Free cash flow to the holding company was €154 million in the fourth quarter, driven by €370 million of dividends from our subsidiaries. This brought the cash capital at the holding to €2.5 billion at the end of the fourth quarter.

The Solvency II ratio of NN Group increased to 241%, mainly due to favorable market movements. Please note that the reversal of the suspended buyback program and the deduction of the proposed 2016 final dividend are both reflected in this ratio. This robust position allows us to propose a final dividend for 2016 of €0.95 per share, bringing the 2016 full-year dividend to €1.55 per share.

I will now turn to slide number 4. NN Group aims to help people secure their financial futures, while delivering an excellent customer experience based on transparent products and services and long-term relationships. We do this by investing in new and improved products and by innovating our customer experience.

Let me give you some examples. Our Dutch pension business has introduced new features to its product proposition including the option which allows customers to increase their individual savings within defined contribution products. And in Romania, we have written over 10,000 new health policies since April, which was double our expectation.

We continue to implement efficiency initiatives which benefit our customers. In the Netherlands, several new products were made available in the online portal called My NN and in the NN App. In Belgium, a Home & Family portal was created, where customers are able to modify their insurance, request certificates or file a claim online. And NN Bank introduced a track and trace system for mortgage applications.

Our strategy in the Netherlands is centered around providing digital, personal and relevant services. In previous quarters, I've mentioned the concept of next best actions, which are relevant services or products that we proactively offer during interactions with customers. These suggestions are highly valued by our customers. And in the fourth quarter of 2016, we included over 242,000 of these Next Best Actions in our customer conversations, which is more than the whole of 2015. We've also started to offer Next Best Actions through the NN App and website, and even via Facebook.

So, now let's turn to slide number 5. 2016 was an eventful year for NN Group. In April, ING sold down its remaining stake in NN. And during the year, we executed several transactions as we regularly assess our portfolio of businesses.

In May, we acquired Notus, a financial broker in Poland, increasing our distribution strength in that country. In July, we sold Mandema & Partners, one of our wholly-owned independent insurance brokers. And in October, we announced the transfer of our Irish reinsurance portfolio.

We've always said that we would consider M&A where we believe that we are the right owner of the business and if it creates more value than the alternative of returning cash to shareholders. We initially announced our intended offer for the ordinary shares with Delta Lloyd in October 2016. Since then, we have reached an agreement on the recommended transaction that is supported by the boards of Delta Lloyd. I will talk more about this transaction in the next slide.

And finally, in January 2017, NN successfully issued €500 million in senior unsecured debt and €850 million in subordinated debt. The proceeds of the subordinated debt have been used to fully repay the outstanding hybrid loans with ING Group.

So, let's turn to slide number 6. On the December 23, 2016, we announced that we have reached an agreement on a recommended all-cash public offer of €5.40 per share for all issued and outstanding ordinary shares of Delta Lloyd. This represents a total consideration of €2.5 billion.

We are pleased that this offering has the support and recommendation of both the Executive Board and the Supervisory Board of Delta Lloyd. The combination of NN Group and Delta Lloyd will allow us to strengthen our positions in the Netherlands and Belgium. Customers of both companies will benefit from an enhanced proposition as a result of the complementary product offering and distribution, as well as further improvements in customer service and experience.

The combined group will be better placed to capture opportunities that technological innovation brings and will provide increased possibilities for knowledge sharing and strengthening capabilities and talent development. It will bring a perspective of growth and lead to opportunities for employees of both companies.

We also anticipate that we can achieve meaningful cost and capital synergies and expect a double-digit increase in the dividend per share for 2018 and onwards. All in all, we strongly believe this transaction to be in the interest of the stakeholders of both companies. The offering – period commenced on February 3 and will run through April 7. This means that the transaction will likely be completed in the second quarter of 2017. We will, of course, update the market as required in the coming months.

So, let me move on to our financial targets on slide number 7. So, let's look at how we're delivering on the financial targets that we have set for NN Group as a whole. Firstly, we aim to realize an annual growth rate of the operating result before tax of the ongoing business of 5% to 7% on average in the medium term. Measuring this for the period 2013 to 2016, we have achieved a compound annual growth rate of 11%.

I've already mentioned that the current administrative expense base of our Netherlands units, which are Netherlands Life, Netherlands Non-Life and the Holding entities, is €761 million. We have actually reduced this expense base by almost 25% since 2013 and we are well on our way to reaching our current target of €685 million by the end of 2018.

We expected to achieve 30% of the targeted cost savings by the end of 2016 but the savings to-date are in fact ahead of that. Thirdly, we aim to increase the net operating return on equity of the ongoing business in the medium term compared with a 7.1% in 2013 and have reported 8.1% for 2016.

Aligned with these three targets, we expect, over time, to generate free cash available to shareholders in the range around the net operating result of the ongoing business. In 2014, free cash flow adjusted for the IPO-related items was lower than the net operating result, while in both 2015 and 2016, the free cash flow exceeded the net operating result.

Taking these 3 years together, we generated total free cash flow of €3.2 billion and a total net operating result of €2.9 billion so in line with our target.

Delfin Rueda, our CFO will go into the details of our free cash flow later in the presentation.

So, let's turn to slide 8. As I mentioned earlier, we have today announced that we will be proposing a 2016 final dividend of €0.95 per share bringing the total 2016 dividend to €1.55. This represents a payout ratio of around 51% of the net operating result of the ongoing business which is slightly above our envisaged 40% to 50% payout ratio in our dividend policy.

It is also in line with our aim to pay sustainable and predictable dividends. The proposed dividend will be voted on at our Annual General Meeting of shareholders in June.

In total, NN Group has returned more than €2.1 billion to shareholders in the form of dividends and share buybacks since the IPO two years ago, including the proposed 2016 final dividend announced today. This demonstrates our commitment to return excess capital to shareholders unless we can better deploy it in other value creating corporate opportunities.

And with that, I will now hand over to Delfin Rueda. Delfin?

Delfin Rueda Arroyo {BIO 7032761 <GO>}

Thank you, Lard. Let me start by presenting the 2016 full year results. NN Group reported an operating result of the ongoing business of €1.2 billion for 2016, down 14% on 2015. To understand this decrease, we need to take into account the operating result for 2015 benefited from higher private equity dividends of €221 million, compared with €72 million in 2016.

In addition, the 2015 full year operating result reflects a significantly higher technical margin in Netherlands Life, while 2016 was impacted negatively by €31 million of claims in Netherlands Non-Life, as a result of severe storms. The 2016 full year operating result benefited from lower administrative expenses in the Netherlands and a higher result at NN Bank.

Looking at the bottom line, you can see that the 2016 full year net result decreased 24% compared with the previous year. This largely reflects the lower operating result that I have just explained. A higher negative hedge result in Japan Closed Block VA due to increased market volatility, and a negative result on divestments, partly compensated by higher non-operating items.

The result on divestments include the loss on the transfer of our reinsurance portfolio in Ireland to Canada Life, and a provision that we set following the outcome of arbitration proceedings in respect of NN Group's former insurance company in Korea. Both of these items were recognized in the last quarter of the year.

Please now turn to slide 11, which gives more details about the expense savings in the Netherlands. As you know, in November 2015, we set ourselves a new cost target in the Netherlands, which aims to reduce the annual administrative expenses of Netherlands Life, Netherlands Non-life and the holding entities to €685 million by the end of 2018.

With this target, we aim to reduce expenses by around 15% compared with an annualized cost base at the end of the third quarter of 2015. This expense reduction program is well on track. Since the start of the program, we have achieved total cost savings of €57 million, which represents 43% of the total targeted expense reductions. As, Lard already mentioned, this is ahead of the 30% that we expected to achieve by the end of 2016.

We will continue to work hard to implement a range of cost containment measures to deal with upward cost pressures, as well as investments in the business and to reach this administration (15:23) expense base target as planned.

Let's now look at the fourth quarter performance of each individual segment. And as usual, let us start with Netherlands Life in slide 12. The operating result of Netherlands Life was €163 million in the fourth quarter of 2016. The 5% increase compared with the same period of 2015 was supported via higher investment margin. We continue to focus on increasing the allocation to higher-yielding assets, and this helped to offset the impact of the low-interest-rate environment on the investments. The last 12 months investment spread was 116 basis points. This is lower than 2015, which benefited from higher private equity dividends. However, it remains above the 2013 level of 104 basis points which we indicated that we would work to sustain.

I would now turn to slide 13 for the results of Netherlands Non-life. The operating result for Netherlands Non-life decreased to €13 million from €28 million in the fourth quarter of 2015. As you are aware, the result of the segments can be quite volatile, depending on the size and frequency of claims in any quarter. In the fourth quarter of 2016, we saw unfavorable underwriting performance in both Disability & Accident and Property & Casualty, as well as higher administrative expenses and lower investment income. The combined ratio for Non-life as a whole increased to 104% from 101% in the fourth quarter of 2015.

For a more detailed explanation of developments in the quarter, let's look at the two business lines with the Non-life separately. In Disability & Accident, the operating result decreased to €11 million from €21 million in the fourth quarter of 2015. This was due to an unfavorable claims experience in the Individual disability portfolio which was partly compensated by favorable claims experience in the Group income protection portfolio.

The D&A combined ratio was higher at 105% compared with 101% in the fourth quarter of 2015. However, if we look through the quarterly volatility as a combined ratio for the full year 2016, this was 98%, which is broadly in line with previous years.

The operating result in Property & Casualty was zero, compared with €6 million in the fourth quarter of 2015. This decrease reflects an unfavorable claims experience in the Motor and Miscellaneous portfolios, partly compensated by a favorable claims experience in Fire. The P&C combined ratio increased to 103% from 101% in the fourth quarter of 2015. The full year 2016 combined ratio for Property & Casualty was 108% including the impact of the severe summer storms.

Turning to slide 14, we'll see the Insurance Europe results. The segment Insurance Europe reported an operating result of €60 million for the fourth quarter of 2016. This was 25% higher compared with the same quarter of 2015 as the higher technical margin and higher fees and premium-based revenues were partly offset by higher administrative expenses.

New sales increased to €138 million in the fourth quarter of 2016, up 7.8% from the fourth quarter of 2015 at constant currencies. This was mainly driven by higher Life sales in Poland and higher sales of less capital intensive savings products in Greece.

The value of new business for the full year 2016 decreased to €85 million from €96 million in 2015. This was mainly due to lower interest rates and the impact of the tax on assets in Poland which was introduced in early 2016.

Moving now to Japan Life on slide 15. The operating result of Japan Life was down 20% from the fourth quarter of 2015 if you exclude currency effects. The reason for this decrease is a lower technical margin and higher DAC amortization and trail commissions, which was partly offset by higher fees and premium-based revenues. New sales in this segment increased to €144 million, up almost 23% from the fourth quarter of 2015 at constant currencies.

This reflects higher protection sales and sales of the COLI critical illness product which was launched in July 2016. The value of new business for 2016 increased to €121 million, up 8% from 2015 excluding currency effects. This increase came from higher sales and a shift to a more profitable product mix which more than offset the impact of lower interest rates.

Now, let's turn to Asset Management. Total Assets under Management decreased to €195 billion from €199 billion at the end of the third quarter of 2016. The decrease reflects a negative market performance of €6 billion, mainly as a result of higher long-term interest rates which reduce the value of fixed income assets. This was partly offset, but net inflows of assets were more than €1 billion primarily in third-party mandates. The operating result of this segment increased to €33 million from €21 million in the fourth quarter of 2015. Let me remind you that last year's result including a €13 million of restructuring provision.

In terms of income, fees were up slightly in the fourth quarter of 2016 reflecting higher average Assets under Management and despite the continuing shift towards lower margin assets. The cost/income ratio improved on higher fee income and lower administrative expenses.

And finally, our last segment, Other, in slide 17. The operating result of the segment Other improved to a loss of €10 million in the fourth quarter of 2016 from a loss of €29 million in the same quarter of 2015. The main components of this segments are the holding result, the reinsurance business and NN Bank. So, I will now look at this in turn.

The holding result improved to a loss of €27 million, mainly driven by lower holding expenses. The operating result of the reinsurance business improved to a loss of €1 million from a loss of €7 million in the same quarter of 2015, which was impacted by lower underwriting results.

Finally, the operating result of NN Bank increased to €16 million in the fourth quarter, up 49% year-on-year. This reflects a higher interest margin in favorable other income, partly offset by higher expenses to support the Bank's continued growth, including an €8 million restructuring provision.

I will now move on the slide to cover our last segment, Japan Closed Block VA. Japan Closed Block VA reported a result before tax of €11 million, compared with €24 million in the fourth quarter of 2015. The lower hedge-related losses in the quarter were offset by a reserve increase due to lower lapse assumptions on death benefit policies. The fourth quarter of 2016 also reflects lower fees and premium-based revenues as the portfolio continues to run-off.

And that completes the results of our operating segments. On the following slides, I would like to take you through the free cash flow and the capital position. On slide 19, we show the movement in the holding company cash capital during the fourth quarter, as well as for the full-year 2016. The holding company cash capital position increased to €2.5 billion at the end of 2016.

The free cash flow during the fourth quarter was €144 million, which included dividends of €370 million received from subsidiaries in the Netherlands and Ireland, partly offset by capital injections mainly into Greece and NN Bank. Details of the dividend's upstreams per segment can be found in the appendix to this presentation.

The free cash flow during the full year was more than €1.3 billion, driven by dividends received from all business segments. This was partly offset by €812 million of capital flows to shareholders, which consist of cash dividend payments and the share buybacks executed during the year.

On the next two slides, I would like to talk (25:14) you through the developments in NN Group's Solvency II ratio. On slide 20, we show the movement of the NN Group Solvency II ratio, the Eligible Own Funds and the Solvency Capital Requirement during the fourth quarter of 2016. In the quarter, the Solvency II ratio increased from 236% to 241%, mainly driven by market variances along with some contribution from operating return. This was partly offset by the impact of eligibility constraints and changes in non-available Own Funds.

Now, let me explain the movement in a bit more detail. Starting with the largest movement, market variances, which had a positive impact on the Solvency ratio of 7 percentage points. This mainly reflects the impact of higher interest rates, as well as positive equity and real estate revaluations, partly offset by a steepening of the yield curve.

The operating return had a positive impact of 3 percentage points. This quarter, the operating return includes some negative impact from experienced variances. As I have highlighted in the past, the operating return will move around quarter by quarter. The bucket order reflects a negative impact from eligibility constraints due to a lower SCR, and as a consequence, a lower Tier 3 cap. It also reflects an increase in non-available Own Funds as well as the provision for ING Life Korea.

Capital flows reflect both the reversal of the €333 million deduction of the suspended share buyback program and the proposed 2016 final dividend of €307 million. The SCR decrease mainly driven by an increase in interest rates in the quarter. So, that explains the movement in the fourth quarter.

On the next slide, we will look at the development of the Solvency II ratio over the full year 2016. The Solvency II ratio of NN Group increased from 239% to 241% in 2016. This mainly reflects the positive impact of the operating return of 19 percentage points. Offset by the capital flows to shareholders of €919 million, we have an impact of 17 percentage points. Capital flows include the proposed 2016 final dividend of €307 million.

The operating return in 2016 was approximately €900 million, but includes a couple of lumpy items. These were: the full year 2015 net result of asset management of approximately €80 million; the non-recurring benefits in Japan Life of approximately €50 million; and the impact of the transfers from the separate account to the general account of approximately €100 million in the first quarter of 2016.

The SCR in the operating return shows a release of approximately €100 million on a full-year basis, reflecting the run-off of portfolios, partly offset by the new business result. Note that market variance led to material volatility during the year, but was actually small on a full-year basis.

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

Eilard Friese

Thank you, Delfin. Before wrapping up this presentation, let me briefly mention the announcement that we made this morning that Stan Beckers, our CEO of NN Investment Partners, will retire on the 1st of April of 2017.

I would like to take this opportunity to thank Stan for his contribution to NN Group over the past years. And I'm pleased that we have found a strong successor for Stan within our own Senior Management team. Satish Bapat, currently our CEO in Japan and with extensive experience on asset management will succeed Stan as CEO of Investment Partners and as a member of our management board.

I will now round off this presentation by saying that we are pleased with the results that we have presented for the fourth quarter and the full-year of 2016. Our expense reduction program is progressing well. We remain fully focused on further improving the operating performance of the businesses and are aware that we still have more work to do to achieve all the targets we have set ourselves.

We believe that it is essential to maintain a strong balance sheet at all times. Our capital position remains robust, and this allows us to take an important step in bringing consolidation to the Dutch insurance and asset management markets. It also allows us to keep delivering on our promise to return capital to shareholders by proposing a final 2016 dividend of €0.95 per ordinary share.

We look forward to successfully completing the transaction with Delta Lloyd in the second quarter of 2017. We recognize that combining our businesses will require significant effort from all of us, but will also lead to enhanced opportunities. At the core of all future developments is our ambition to help our customers to secure their financial futures and to deliver an excellent customer experience and to be a company that truly matters in the lives of our stakeholders.

I would now like to open the call for your questions. And as always – as I always do, can I kindly request you to limit the number of your questions to two per person so that everybody gets a chance to speak. And, of course, feel free to come back with a second round of questions if they have not yet been dealt with.

With that, operator, I'm handing back to you for Q&A.

Q&A

Operator

Thank you, Mr. Friese. Ladies and gentleman, we will start the question-and-answer session. Your first question is coming from Mr. Cor Kluis, ABN AMRO. Go ahead, please, sir.

Q - Cor Kluis {BIO 3515446 <GO>}

Good morning. Cor Kluis, ABN AMRO. Got a few questions. First of all about the Eligible Own Funds on slide 20, you showed there that the market's variance was €0.5 billion negative in the quarter. Could you elaborate on that what exactly the pieces were in that because equity markets were – are doing well, interest rates went up. Why was this? Was this mostly driven due to a steepening of the yields curve and because you showed a steepening effect was higher than in the past in the sensitivity analysis? At least, just a bit of that one?

And second question is about the Solvency II ratio at this moment. A lot happened, of course, in the first quarter. Sand (32:31) rates went up (32:33) went up, steepening was more. Could you give an indication what the Solvency II ratio would be at this moment? It's probably going to be lower than the 240% or 241%? Those were my questions.

A - Eilard Friese

Thank you, Cor. Good morning. I will hand that to Jan-Hendrik Erasmus, our Chief Risk Officer.

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

Hi, Cor. Thank you, Lard, for the question and Cor. Yeah. The first thing, just to notice that interest rates went up in the quarter. So what we saw is that of course our Solvency capital requirement came down during the quarter. And Solvency II has a rule that your Tier 3 capital cannot be more than 15% of your Solvency capital requirement.

So as that number comes down, so your Tier 3 capacity also comes down, and that's what you see in that effect is that we have some deferred tax assets which are – they still have economic value, but under Solvency II, we don't get value for them. Together with that, there was a small impact of some non-available Own Funds, which resulted from an injection we put into a unit that is now considered to be not fungible.

On the second question, the ratio for the year-to-date, I think we have some headwinds. You can see them yourselves in the markets. We disclosed some sensitivities to government bond spreads, and those have continued to widen for some of the high quality sovereigns in Europe, so we expect that it's a little bit lower than the year-end number.

Q - Cor Kluis {BIO 3515446 <GO>}

Okay. Very clear. Thanks.

Operator

Next question is from Mr. Farquhar Murray. Go ahead please, sir.

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

Good morning, gentlemen. Just two questions, if I may. Firstly, the DNB has issued kind of new guidelines from the LACDT. I just wondered if you could work through which elements of those you regard as new versus the prior guidance and what the implications are, if any, for NN's Solvency II ratio?

And more generally, when might we get confirmation from the DNB that this issue is settled, because obviously I think the guidance talks towards the second quarter of 2017?

And then secondly, just on the Solvency II sensitivities, could you just explain why the sovereign spread sensitivity has increased between the first half and year-end? Does that reflect increased sovereign exposure or are there other dynamics going on there? Thanks.

A - Eilard Friese

Yeah. Thank you, Farquhar. So the second question on the sensitivities will be answered by Jan-Hendrik, but let's first do the LACDT question. So, Delfin, can you take that one?

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

Yes. Thank you, Farquhar. So indeed, I think it – I mean, last Friday, there was a new guidance from DNB on the LACDT. So we have taken that guidance very carefully into account, and our approach at year-end 2016 is fully compliant with this guidance. And I mean, trying to explain what has changed from this guidance to the previous one within the call, as you know, will be I think quite messy. But I think that the important element to reinforce is that our LACDT calculation in our full year 2016 numbers is according to this guidance.

A - Eilard Friese

Jan-Hendrik.

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

Thank you, Farquhar, for that question. Our sovereign exposures haven't significantly increased. We still remain comfortable with the high proportion of sovereigns as part of what we consider to be a relatively defensive (35:55). The increase in the sensitivity you see is primarily caused by the tiering that I described earlier. Essentially, you get a loss-absorbing effect if you had - don't hit your Tier 3 cap. And when you start hitting it, you'd get less loss-absorbency from deferred tax asset that you would set up in those scenarios. So it's primarily caused by the Solvency II tiering.

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

Okay. Great. Thanks much.

Operator

Next question from Mr. Michael van Wegen, Bank of America. Go ahead please, sir.

Q - Michael van Wegen {BIO 6435238 <GO>}

Yeah, morning, guys. Quick one or two. First of all, can you indicate on a pro forma basis, including the Delta Lloyd acquisition, what capital levels you feel comfortable with, because I think you talked about a pro forma Solvency II ratio of low 190s or mid 190s at the Q3 stage. I think that how things are developing right now, that would be under further pressure. So, will be good to understand where - what capital levels you feel comfortable. And can you talk about an updated pro forma Solvency II ratio with Delta Lloyd, or is that, given Delta Lloyd hasn't reported numbers at this stage, not possible. Thank you.

A - Eilard Friese

Thanks, Michael. Delfin?

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

Yes. Thank you, Michael. Yes, as you can imagine, without the - having the disclosure of Delta Lloyd that come in next week, will be imprudent to comment on new pro forma ratios.

What we have - I would highlight two things here. I mean, one is the very strong starting position of our Solvency ratio as has been mentioned before, it has increased by 5 percentage points in the quarter. We are at 241%. And indeed, the pro forma as of September 2016 was in the mid 185%, including some expected adjustments as we flag it at that point of time.

I believe that that level of Solvency is obviously less generous that we have been used to, but is still very comfortable going forward.

Operator

Does it answer your question?

Q - Michael van Wegen {BIO 6435238 <GO>}

Thank you.

Operator

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

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

Yes. Thank you, gentlemen. Just two questions. The first one is on this reduction or the reduction eligibility with reference to Tier 3. If I look at your group Tier 3 capital, it's gone up from 11% to 14%, the actual number has gone up while the SCR has gone down. So it doesn't look like this is the case at the Group level, but maybe the constraint is kicking at the Netherlands Solvency – the Netherlands – the division. So can you just clarify that?

Secondly, on the P&C, it doesn't seem that you're getting better. Like, it's a 108% now in the P&C division. So just curious as to why it's not improving. Is there underlying trend deterioration and do you expect to get better in 2017?

A - Eilard Friese

Yeah. Thanks, Arjan. Let me take the P&C question first. And then, I will ask Jan-Hendrik to comment on your eligibility question.

On Non-life. Non-life results, as we all know, are volatile by nature. So, I also want to remind everybody of the big storm that we all had in the Netherlands and may begin June. We also had large fires in 2015, and there is month-to-month some volatility that we've seen in Individual disability.

But it's good to take therefore a view across the borders first to look at the underlying trends. And if you see that is that overall, and despite some quarterly volatility, our D&A book actually runs at a combined ratio of around 98% for the past three years. And this is quite healthy for a business that is long tailed. And please note, that this was on the back of an improvement program, because we turned around this lock-up business in the recent past and is, as I said, running with a meaningful operating result of more than €90 million per annum, and at a 98% combined. So that's the D&A business, a large piece of our Non-life company.

Then we have worked hard to improve the Fire business. And if you take out the storm effect, the underlying combined ratio is 95%, on which the Fire business runs on 2016. We've reduced expenses and we will continue to do so, but you saw the expense ratio also improve this year. And so the real underperformance in Non-life is driven by the Dutch Motor book and that's where we have taken action. And we will continue to take action by calling non-profitable products and by repricing the book.

Now, I note here though that it takes time for this to translate into better results, and I will explain to you why. Number one, there is a reality of a highly competitive marketplace which hampers our ability to reprice as forcefully as we would like to, and we also are confronted now and then with adjustments on older claims that we need to settle over time. So please bear that in mind.

Now moving forward, we will continue obviously with our progress – with our work to improve the results reducing expenses further – we should really need it in the Motor book, and also underwriting actions were needed to ensure that we work toward our combined ratio target.

Now with that, I would like to hand over to Jan-Hendrik on the first question that you had, Arjan.

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

Thank you, Lard and Arjan for that question. Arjan, you are right firstly to say that this impact was larger in the Life company than at Group level. But we still saw a small impact at Group level, because this tiering is actually based on the Solvency II internal model SCR, if you like, and that excludes the non-Solvency II entities. So the 14% you see is not exactly the right number to compare it with. On the other hand, your insight is also correct.

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

Can I just ask one last? So, if the DNB is stricter – you've already capped some of your LAC-DT now. So it's only potential reductions you already probably would do so now effectively.

A - Eilard Friese

On LAC-DT? Delfin, you want to comment?

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

Yeah. I think we are talking about different things. The LAC-DT is basically impacting the level of the (42:56) capital requirement. And then we talk about the Tier 3, is the deferred tax assets that tier impacting own funds (43:04).

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

Okay. So, they are quite mutually exclusive?

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

Yes. Thank you.

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

Yeah. Thanks.

Operator

Next question is Ashik Musaddi, JPMorgan. Go ahead, please.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Hi. Good morning, everyone. So, just one question with respect to the cash that you are upstreaming from subsidiaries. I mean, your guidance has been very clear that it should be roughly in line with the operating result. But for past couple of years, it's materially higher, I mean because – it's materially higher. So, what is driving that and where do you think, going forward, will that be lower because – I mean, Dutch Life continue to give a stable number, Dutch Non-life as well. So, any thoughts on that? Where do you think the cash release would be lower going forward? Thank you.

A - Eilard Friese

Yeah. Thank you Ashik. Delfin, would you be so kind?

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

Yeah. So, obviously, in order to have a amount of free cash flow generation on the range of the operating result, taking into account that there are also holding expenses on the cost of debt, you need to have a higher increase – higher dividends coming from the subsidiaries in order to maintain that.

So, I think we have seen over the last couple of years a very strong flow of dividends from subsidiaries. That was also the case in this quarter and, I think, important to mention that that was achieved without deteriorating the level of solvency in these entities. And that, of course, is a critical element when looking at our level of solvency and the ability to generate capital going forward.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Thank you. And just one more follow up question on the sovereign spreads. I mean, sovereign spread is kind of widening at the moment, but it's still relatively tighter. I mean, is there any way you are thinking about locking those sovereign spread, o, virtually it's very difficult and maybe uneconomic as well to do that? Thank you.

A - Eilard Friese

Yeah. Thanks, Ashik. So Jan-Hendrik?

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

Hi. Thank you, Ashik, for that question. The sensitivity we disclosed is, of course, to all sovereign spreads moving in parallel by 50 basis points at the same time, which is a relatively big shift. And we also need to think about the underlying economics which is that, we think we are more exposed to default risk there than spread risk. Spread risk, of course affects the timing of your capital generation, but the real underlying risk is default risk. Of course, we are considering many options, one of them is spread locks and we tend to do these things when it makes sense to them rather than to be forced into them.

Q - Ashik Musaddi {BIO 15847584 <GO>}

And at the moment you don't think it's necessary to lock it?

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

It's one of the options we are considering. But as I have explained before, I think our Solvency position is very strong at the moment, so we will only do it when it makes sense.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay. Thank you.

Operator

Next question is Mr. Benoît Pétrarque, Kepler. Go ahead, please.

Q - Benoît Pétrarque

Yes. Good morning. One question on the capital generation and another on Non-Life. First of all, on the Own Funds generation, €0.1 billion rounded figure, could you maybe provide a bit of granularity in terms of how much it is in millions and also, the impact of the experienced variances this quarter. I think, over time, variances should be close to zero so, I was wondering if you were more close, kind of, to €150 million this quarter on the clean (46:39) basis or closer to €100 million.

And also, maybe on the SCR for the full year 2016, how much is coming from NN Life versus Japan VA? Could you also give us a bit more details on that? And then on Non-life, I was wondering if the disability volatility is kind of a trend now? I mean, it's – combined ratio is up this quarter. Are you expecting a slightly higher combined ratio in the coming quarters as well or is just volatility in the quarter? And on premiums up 9% in Q4 versus Q4 2015, is that the kind of first sign of the repricing we have been talking about? Thank you very much.

A - Eilard Friese

Benoît, I didn't catch your last question, but first on the D&A volatility, is to – maybe you want to repeat that. But first, on the D&A volatility, that's really volatility in the quarter. So, that's it.

And again, over the – we've seen some volatility during the quarters, but overall it's a 98% combined. I think was your last – so your last...

Q - Benoît Pétrarque

Yeah, the last question was on – if you look at the Non-life business, earned premiums were up 8.5% in Q4 2016 versus Q4 2015. It is quite nice increase of premiums. Is that fully repricing which is starting to be visible now?

A - Eilard Friese

It's nothing special, so – but it's partly that plus some growth in some part of business, et cetera. So, I wouldn't – there's nothing special in that particular line. Let me go to the operating return question that you have. So, Delfin, would you be able to take that one? Yeah. Thank you.

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

Yes. Benoît, so in terms of the operating return in the quarter, as I've mentioned in previous quarters, this is influenced by quite a number of factors. In the full year, as you saw, we had the operating return of approximately €900 million in (48:47) and a release of approximately €100 million during the year. And obviously, when you look at a larger period of time, this is the first year that we report in a capital generation of the Solvency II. I mean that gives a better indication of how things move.

During this quarter, we witnessed some negative experience. As I said before, some negative experience variances in Life and Non-life. And this can move around from quarter-to-quarter. In addition, in the last quarter of the year, we saw a strong sales in Japan which reduced the capital generation due to the initial new business strength (49:38).

In terms of how to split the SCR from Life and the Japan Closed Block VA run-off, I mean, the Japan Closed Block VA run-off, you have seen the indications that we have provided. We still have €400 million that – as expected, to be free-up up to 2019. And keep in mind that also in the movement of the SCR there is the contribution or the drag due to new business.

Q - Benoît Pétrarque

Okay. Thank you.

Operator

The next question is from Mr. Gordon Aitken, RBC. Go ahead please.

Q - Gordon Aitken {BIO 3846728 <GO>}

Good morning. Couple of questions please. First, on costs. The head count is essentially unchanged over 2016. Usually a large component of cost bases of insurance companies are staff. And even if you weren't making any return this season (50:36), I expect you still could reduce the head count by not hiring and the replacements for those that leave. So, if you could explain that one please?

And secondly, on the Dutch buy-out market, it's been very quiet for years now and you've been, I suppose even less than quiet and not doing very much. But anyway, essentially you are taking on a huge number of DB schemes with the Delta acquisition. So what's the outlook for this market and your participation in it please? Thank you.

A - Eilard Friese

Yeah. So, Gordon, first on the second piece, which is the Dutch buy-out market. We've always maintained the view that we only write this business if it meets our pricing requirements. We have done a large transaction last year actually, €420 million, I believe by heart (51:22), which did meet our requirements. But if it don't, then it doesn't fit. So, we're just taking a rational approach to that, and we will continue to do that in the future as well.

In the outlook for the market, the Netherlands is very much, that defined benefit will move to defined contribution. That is a trend, obviously very much influenced by the low interest rate environment and longevity and the affordability of those plans for employers. So what you see happening is that the renewals that take place are largely renewals that become defined contribution plans.

Now, please note that this is new money, so for the new period – for the new periods, and therefore, the stock on your balance sheet will come down as these contracts migrate to, let's say, defined contribution, but that takes time. So, it will be a gradual move because the in-stock of the past is of course on your balance sheet, while the new money is something that is usually contracted on a defined contribution basis.

If we then go to the first point about expense reduction, well, first of all, I think we are making good progress there. If I look at what we've done over the last years since we entered into this journey, we took 25% out of the cost base in the Netherlands, in scope areas. Secondly, we're progressing ahead of our guidance when it comes to the additional expense reduction plan. So, we're actually quite pleased with the way the company is on its road to reduce expenses. Now, please note, this is not only about head count. Headcount indeed is a large piece of the expense base, but is also a lot to do with technology. So we're doing a lot in changes in technology, leases, re-procurement of networks, data – server consolidation, all these things. And also, these things contribute, including square meter usage in locations and the like. So, there's many things that contribute to the expense reduction program.

The FTEs, please note that you're looking probably at the aggregated number, which means that Japan and Europe are up actually in FTEs since they have growth and that's where we hire people, so that's one thing.

And the other one we also do, as part of the expense reductions by the way is that we have externals that are sometimes more expensive than hiring on a full-time basis. And on a selected basis, we also move externals that are actually more permanent into permanent contracts because that is better in terms of – financially, so that's why.

Q - Gordon Aitken {BIO 3846728 <GO>}

Thanks very much.

Operator

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

Q - William Hawkins {BIO 1822411 <GO>}

Hello. Thank you very much. Delfin, when you were talking about the one-offs in the operating capital generation on slide 21, you referred to that €100 million of shift from SA to GA. When that happened in the first quarter, you were saying that was seasonal rather than explicitly one-off. So, can I just confirm that that is seasonal and we should be expecting another similar figure in the first quarter of 2017.

And then secondly, in your prepared remarks, you didn't make reference to a morbidity weakness in the Dutch Life result that offset the benefits of higher yields. Forgive me if this has come up before, but I'm really not even sure what the morbidity issue would be in your Dutch Life portfolio.

So, very briefly, can you just say what is the issue and can we be sure this is just a one-off or is that something that needs to be addressed in the future? Thank you.

A - Eilard Friese

Thanks, William. So, Delfin?

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

Thanks, William. Yes, indeed the shift from the separate account to a general accounts tends to happen, most of it within the first quarter. That doesn't mean that there could be a small transfers during the rest of the year. But also for 2017, we would expect the same thing happening in the first quarter of 2017.

Obviously, as this separate account is becoming smaller, this will be a time which is getting closer, on which there won't be further changes. So, this volatility in the operating return will eventually go away. In terms of the morbidity results which were quite negative in the quarter for Netherlands Life, just maybe to explain what it is, I mean, this relates to cases of disability on which the pension – they hold a pension clients – when they became (56:15) disable, we cover their pension premium ourselves. But this is something that can be – can occur, can be volatile. But basically, that impact in the quarter did not only reflect the movement in the quarter, so there was some part of it related to previous periods. So, there was a bit of a catch-up in recognizing that morbidity, weaknesses. So I would not consider that as a recurrent item.

Q - William Hawkins {BIO 1822411 <GO>}

Thank you, guys. (56:59-57:11)

Operator

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

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

Yes. Good morning. Thank you. Just to come back on the operating return. You referred to the negative impact of the growth in the Japanese business. Could you quantify that product stream impacts both on a quarterly and a full-year basis, please?

And also linked to the operating return, we've seen increasing interest rates, recently some spread movement. So, just wonder whether you could say anything on how this impacts your capital generation going forward. So, I think in the past, you gave for interest rates, you have (57:54) so maybe you could update us on that number as well.

And then secondly, just to come back on Cor's question on the €0.5 billion negative market variance impact in own funds. I'm not sure if I understood the answer, but I think it could be helpful if you could break that down between the rate spread and equity, because I was also expecting less negative or really small positive for that number. So, maybe there's some non-economic item as well you could highlight. Thanks.

A - Eilard Friese

Yes. So, Matthias, thank you very much. Let's start Jan-Hendrik with the negative market variance in own funds, and then Delfin will take the other components of your question.

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

Hi, Matthias. Thank you for the question. I mean, the negative market variance in own funds is primarily from rising interest rates. I think, we have to go back to how we do our asset liability management. We have said in the past that we don't hedge the UFR or the risk margin. We try to match asset cash flows with liability cash flows. And that means under the Solvency II framework that you see that when rates go up, our own funds will go down, and that's what we have seen. So, pretty much as expected.

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

And you would look at it on an economic basis without UFR, I guess, you would have shown a positive fund number there or?

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

Well, I think on an economic basis, it's pretty much a better match, right. So, we're trying to match it closely on an economic basis or on a cash flow basis.

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

Okay.

A - Eilard Friese

Delfin?

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

Yes, Matthias. So, on the impact on the operating return from Japan, I think it's important to understand that as Japan is not a Solvency II entity, the dividends and the capital generation are driven by the Japanese GAAP profits. And as a consequence, due to the initial acquisition cost, sales in Japan results into a Japanese GAAP profit strain as – is not recognized the deferred acquisition cost in the same way that we do under IFRS.

However, obviously over time, the sales will result in a growing in-force profits and, as a consequence, higher capital generation. So, that is why when Japan increases their sales, it depressed somehow the capital generation. We have not specifically quantified that amount. I am not sure if there was another question. I think how does it impact the capital generation going forward?

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

Yes. The rate...

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

Yeah. I remember now the question. So, it's about in the operating result, how the higher interest rates will impact capital generation. And certainly with higher interest rates and higher spreads, we have negative impact on own funds but as we explained in the past that result into higher capital generation going forward and I think as you know is related to different aspects but I think that's the key message to take away. We should not be quantifying it from one quarter to another.

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

Okay. Thanks a lot.

Operator

Next question, Mr. Bart Horsten, Kempen & Co. Go ahead please, sir?

Q - Bart Horsten {BIO 2390919 <GO>}

Yes. Good morning. Thank you for taking my questions. As a follow-up on Japan Life. Well, it seems you're doing all the right things. If you look to the growth and you just said, okay, through the initial cost, (01:01:53) through in the IFRS results, when do you think that we can see the impact on that from a higher free cash flow coming – or dividends coming out of Japan? That's my first question.

The second question relates to more in general, the sensitivity of you sensitivities appears pretty volatile. And I was wondering whether that was all related to the lack of headroom in the Tier 3 part or are there other reasons for that?

And if I may, one final question is, we've seen some news flow recently on some unit-linked claims after relatively longer period of silence and I was wondering if you experienced the same or is there anything out of – from NN on this topic which you could highlight on that? Thank you.

A - Eilard Friese

Thank you very much, Bart. Let me start with the last question that you had about the unit-linked claims. There was some news flow indeed recently on a couple of rulings vis-à-vis other participants in the industry.

When it comes to ourselves there is nothing to update you on today. There are – may be good to remind you that there are, obviously, pending cases and they may come to rulings in the course of this year. So, that's that one. Then on sensitivities – of your sensitivities. So, Jan-Hendrik, and then the first question will be done by Delfin, Bart.

Q - Bart Horsten {BIO 2390919 <GO>}

Okay.

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

Thank you, Bart. Yes. I mean, the last time we disclosed the sensitivities was Q2, and indeed if you compare the Q4 sensitivities, you will see that these are higher. For the majority of the change, it really is this DTA gap which I should reiterate is not an economic effect, it's an effect caused by Solvency II tiering rules.

There is also – we had in Q3 an update of the VOLA Reference Portfolio, the volatility adjuster, and that is now less of a good match, if you like, with our portfolio. So, that has also contributed a little bit to the increasing sensitivities that you see from Q2 to Q4. But apart from that, there's nothing else in there.

Q - Bart Horsten {BIO 2390919 <GO>}

Okay.

A - Eilard Friese

And then Delfin on the growth in Japan Life.

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

Yes. Indeed. As you know, for Japan Life, the impact on the – when you focus on the quarter, I mean, in the quarter in the Q4, basically, there is some drag because of the technical margin in Japan, and that is related to more negative mortality results and a lower surrender. Mortality results were worse than in the same quarter of last year, and there were some lower surrender results there.

And I think that is the main element dragging the profitability in the quarter under IFRS. I mean, our premium income has grown close to 30% excluding currency impact. All being equal, this will drive profit growth due to the corresponding growth in fee and premium revenues - base revenues as we move forward in the quarters to come.

Q - Bart Horsten {BIO 2390919 <GO>}

Okay. Thank you.

Operator

Your next question is from Mr. Darshan Mistry, Citi. Go ahead please.

Q - Darshan Mistry {BIO 19807857 <GO>}

Hi there. Thank you for taking my question. Firstly, just coming back to this LACDT issue. I was wondering whether you're able to be say - how much of your higher recoverability rates compared to some of your peers is due to the fact that you have a well-capitalized group with a significant amount of free cash at the holding company. And whether - for example, if that were to change because of an acquisition or other use of that free capital at the holding company, would your ability to recovery LACDT change? And so, could we see a reduction in your recoverability rate?

And the second one was on your - on Polish pension fund reforms. I noticed some kind of news flow over the last week on - of dates, to the kind of pension fund reform in Poland, so I was wondering if you could give us an update on your expectations and how that might evolve in - or impact that might have on your European business?

A - Eilard Friese

Yeah. Thank you very much, Darshan. So, on LACDT - LACDT, sorry. This is to Delfin, and I will take the Polish one later. Thank you.

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

Darshan, yes. You're absolutely right. I mean, the two factors, the level at which you are capitalized, as well as what is the prospects of capital generation (01:06:44) play a role. I think that our ability to use the LACDT is driven by both. We should not underestimate also what is the capital generation capability of our different business, as you know, post-shock. But, no doubt, with less capitalized situation to start with that might reduce in the future somehow the LACDT, the ability to recognize LACDT going forward.

But I wouldn't mention this as the main aspect now because the capacity to originate profits going forward is very significant.

A - Eilard Friese

Yes. And then, Darshan, on the Polish pension reform. There is indeed some recent news flow where the original ideas have now been endorsed by the government itself and they need to bring their - what they call the strategy for - they call it themselves, a responsible development. They need to bring that now to parliament.

So, it's a little bit too early to comment on the exact effects that it will have because it will require discussion in parliament and we need to await those consultations to have a final piece of legislation that we know is going to be introduced. So, that's a bit too early.

But, in summary, it's not really possible at this moment to fully assess the impact on us given the fact that it still needs to go through parliament. But, if the proposal will be adopted in its current form, basically, short-term, it may adversely impact the profitability of our Polish pension business. But longer term, it also leads to opportunities for the business structurally.

Q - Darshan Mistry {BIO 19807857 <GO>}

Okay. Thank you.

Operator

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

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi, guys. Just two quick questions. On the SCR, you've alluded to the DB to DC trend, in terms of renewals, which is a slow trend in terms of capital release. But, how many years is it going to take, in your view, before we reach that wave and we start to see a more material reduction in NN Life SCR in the DB book. That's question one.

Question two is, what can you do to address the Tier 3 issue because it feels like it's only going to get bigger for you as time go on. And also, it could be a complication with the Delta Lloyd acquisition. So, what can you do in terms of mix of capital that reduces that sensitivity and what actions are you taking? Thanks.

A - Eilard Friese

Yes. Thanks, Farooq. So, first on the – on your first question, it's – I don't have a specific time line for you, but it's going to take long. As I said, the existing stock of defined benefit plans are on your balance sheet. The new money is often times, and most of the times, renewed on a defined contribution basis.

But, before that, let's say, defined contribution has completely overtaken the stock of defined benefit that's really going to take quite a while to materialize. So, it's a slow movement, which we've always said it would be a slow movement on the balance sheet, but it's of course a market movement which is quite pronounced for which we are very well positioned.

We have various rods in the pond, a good product line, and a good business to capture that opportunity.

Q - Farooq Hanif {BIO 4780978 <GO>}

If I may quickly follow up on that.

A - Eilard Friese

Sure.

Q - Farooq Hanif {BIO 4780978 <GO>}

I just – I know you – it's impossible but it's very actuarial but are you basically saying, look, in a typical analyst 3-year to 5-year timeframe, don't factor this in at all?

A - Eilard Friese

I would certainly not think that you will see a massive change in the balance sheet in 3 to 5 years. No.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thanks.

A - Eilard Friese

But you will see this trend. So, Farooq, so it's a trend, but it will be quite slow and gradual. About the composition of the capital, Delfin?

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

Yeah. I think the question, Farooq, is about what we can do about the tiering and somehow, as you know, the tiering works as it works and sometimes it comes in your favor, sometimes comes a little bit against you. So, clearly, this quarter with the reduction on the solvency capital requirement and consequence also with the reduction of the value of our fixed income securities that has increased the deferred tax asset and at the same time the tiering cap has reduced. I think that for Tier 3, there is not much to do. We'll always be limited to the 15% cap. Maybe – I don't know if Jan-Hendrik, do you want to add something on this?

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

Yeah. I think that's right, Delfin. Just to add one comment. It's a funny dynamic because the one thing we can, of course, do is to increase our SCR by taking more risk, and then we would have more Tier 3 capacity. So, it does increase the resilience a little bit if you think about that. But, apart from that, we are bound by the rules.

Q - Farooq Hanif {BIO 4780978 <GO>}

So, you won't consider taking more Tier 2 or other actions like that?

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

In terms of – I mean, as you know, as from January 1, we no longer have the restricted Tier 1 subordinated bonds from – owned by ING Bank. So, that has reduced our Tier 1, and we replaced that already with €850 million of Tier 2. So, we have already increase the tiering of Tier 2, and these ratios, of course, will be presented as part of Q1.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thanks.

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

Thank you very much.

Operator

Next question is from Mr. Steven Haywood, HSBC. Go ahead, please.

Q - Steven Haywood {BIO 15743259 <GO>}

Good morning, everyone.

Just two questions, please. On the Non-Life business, you still have the 97% combined ratio target for next year. Do you think this will be achieved? And then there was one of your peers flagged this morning about personal injury claims have a substantial negative impact on their earnings due to changes in laws and regulations. Could you describe what's going on here and if you're seeing similar changes as well?

And then, second question, on the ING Life Korea provision, are we to assume this is around the €60 million impact here? Thank you.

A - Eilard Friese

Yes, the first, Delfin, maybe you can do the ING Life Korea, and then I'll come back to you Steven, on Non-Life points.

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

Yes. In Life Korea, we have not disclosed any amount, and we have done that on purpose because there is still some negotiations as we speak. And therefore, we consider that to be commercially sensitive. The result of both Korea and the transfer of the NN Re Ireland portfolio are reflected in the line of – in results from divestments.

A - Eilard Friese

Yes. On your first two question Steven. We keep our commitment to work towards the 97% combined ratio, but obviously right now is that we need to do more work to reach it. When it pertains to your other point on personal injury, I can't comment on the results of peers, obviously, personal injury is not significant for us.

Q - Steven Haywood {BIO 15743259 <GO>}

Okay. Thanks very much.

Operator

The next question is from Mr. Darshan Mistry. Go ahead please. Your line is open.

Q - Darshan Mistry {BIO 19807857 <GO>}

Hi. Thank you. A couple of follow-up questions please. Firstly, you're going to be taking – if the Delta Lloyd acquisition goes through, you're going to be taking on a lot of longevity risk. And so, are you considering the use of longevity swaps or longevity reinsurance? And if so, can we expect a material capital benefit from doing so? That was one question.

And the second question is, your Solvency II sensitivity, they obviously still remain quite volatile. And in the event of you lowering – your capital ratio being lowered to around the 180%, 185% level, could we expect you to take some sort of actions and some changes in you hedging policies to reduce that volatility? Thank you.

A - Eilard Friese

Thanks, Darshan. Jan-Hendrik?

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

Thank you, Darshan, for those questions. Yeah. You are right that we will be increasing after the transaction, and if it completes as planned, our exposure to Dutch longevity risk. And we are, of course, preparing for many scenarios, and we have been investigating for several years, the opportunity to offload some of that risk when it makes sense for us.

At this stage, I think it looks relatively promising. If you look at the market, that you can get capital relief from those levers. But, of course, it's premature to speculate today on exactly what we will do after a transaction that we have not yet completed, et cetera, et cetera.

On your second point, it's a little bit the same. I mean, we have not yet completed this transaction. The latest guidance was the pro forma Q3 guidance that we gave on December 23. So, again, we will have to consider our sensitivities very carefully after the transaction is completed. We are aware of many things we can do with our balance sheet and we are always preparing for different scenarios. But, it's premature to speculate.

Q - Darshan Mistry {BIO 19807857 <GO>}

Thank you very much.

Operator

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

Q - Steven Haywood {BIO 15743259 <GO>}

Thank you. Just another question, more a case of what you plan to do in the future. Your €2.5 billion of cash holding, if you take away the final dividend and the cash cost acquisition of Delta Lloyd, you get to about €800 million. But then, if your free cash flow in 2017 is again, €1.3 billion or higher, you get to over €2 billion minus an interim dividend, you're still around the €2 billion level. What is your plan, because you're going to be considerably above your sort of maximum excess capital position – at the holding company target by the end this year. Can you talk about any plans for a future capital repatriation again, or it's a wait and see time?

A - Eilard Friese

Yes. Delfin?

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

Yes. Thank you, Steven. So, basically, with the acquisition of Delta Lloyd, we're not intending to change our capital management or dividend approach. So, we will continue be applying the same approach of if there is to assist any surplus capital to repay it back to the shareholders in the most efficient manner, share buybacks, being of course as you know one of the alternatives that (01:18:04).

However, I think at this point, it will be a bit of premature to start speculating when and how that will take place. We still are hoping – expected to complete that transaction by mid-April. That will put €2.5 billion of surplus – a part of the surplus capital at play, and from there, we'll have to see, you know how the cash capital at holding develops. But the key message here is no change of the capital management and dividend policy as we have explained in the past.

Q - Steven Haywood {BIO 15743259 <GO>}

Okay. Many thank you.

A - Eilard Friese

Operator? Are we – yes. So I think...

Operator

Yes, sir?

A - Eilard Friese

I think there's no further questions?

Operator

There's one additional coming up.

A - Eilard Friese

Okay. Thank you very much.

Operator

It's our last minute. That's Mr. Ashik Musaddi, JPMorgan.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah. Hi. Sorry. Just one follow-up. Can you give us some indication about what are the – I mean, how much more re-risking possibility is there in your current NN book? I mean, are you looking to do – continue to do a bit more or you think that current asset profile is more or less the same? And just including that, I mean, any thoughts about your European operations. How should we think about growth in that, growth in earnings from European operations? Thank you.

A - Eilard Friese

Yeah. So, Ashik, the first question will be covered by Delfin. The second one, I'll give you some views on the Insurance Europe.

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

Yes, Ashik. Yes, you have seen that during the year in 2016, we basically allocated approximately €4.5 billion into these higher yielding assets. As, I have explain in the past, it's very much a question of availability of the fixed income, securities or the assets that fit within our ALM approach, but we will gradually continue with the same approach that we have done so far. And there is still room, not only for mortgages, but also other assets in order to continue that journey. That is gradual. Has not been in one go or very drastic any quarter, but you could expect the most likely evolution following that same pattern.

A - Eilard Friese

Yes. And, Ashik, and when it comes to Europe, you know that at the time of the IPO, we set ourselves a target there, which is mid-single digit, on average, earnings growth target for Europe. Obviously that is a target that maintain, and we continue to drive towards. And if I look what the business there has been doing, it's really markedly changed its product mix away from guaranteed products to spread and – from strong spreads to fee products and protection, which I think has gone quite well. Building out distribution – organically, but also inorganically by buying for instance the broker in Poland.

So, that's our target. That's what we're going to work towards. At the same time, we keep the expenses under control and that's what you basically see happening in Europe.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay. Thanks. Very clear.

A - Eilard Friese

I think with that – with that, I think it's time to conclude the call. I want to thank you very much for all your questions. Let me conclude by saying that our priority remains to improve the operating performance of our businesses, to increase earnings, and generate cash. We're making good progress, but we still have more work to do to achieve all the targets that we have set ourselves.

And looking forward, we will never lose sight of our main purpose, and that is to help our customers to secure their financial futures. I want to thank you for all your questions, your time, and your attention. And I wish you a very good day.

Operator

This concludes the NN Group analyst call. Thank you for attending, and you may disconnect your line now.

FINAL

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