Presentation of PZU's 2016 financial results

Michał Krupiński, President of the Management Board, CEO of PZU Group:

Good morning, ladies and gentlemen, please accept our apologies for the delay in our conference. We'll try to finish in an hour. We have learned a lesson that it is not good to announce results when there is an important election in the Netherlands and the FOMC meeting. However as we look at our stock prices, they perform much better than the market, which makes us really happy. We will try to go through the most important slides quickly. I understand that you are already familiar with most of the information. Perhaps I'll go straight to the presentation. Today, we have: Tomasz Kulik, Financial Director and CFO of the Company, and Paweł Surówka, President of PZU Życie, who is also responsible for PZU Group's investments.

Let's look at the agenda of the presentation. We will talk about:

1. A little about the market;
2. Implementation of the Group's strategy; we are happy with how the strategy is implemented and we believe that it is implemented in almost 100%;
3. These are the key factors that contributed to our result in 2016;
4. Summary of financial results. We can go through the details and also talk more about the 4th quarter.

As for the market, there was an increase in gross written premium in property insurance. As you can see, there are two factors at play. The first is an increase in prices, and the second is a change in the number of policies. In the life sector, the market was in decline. And what is our position on that market? We posted record premiums. And that was what we intended. As you remember, this is something that we also announced in the strategy – we decided that the Company had lost too much of a market share. We are particularly happy with the 3% increase in non-life insurance. We crossed the magic milestone of 20 billion zloty. We are also pleased to have 700,000 new clients in corporate insurance. This is because of the implementation of the Everest software, which allows us to have a better price to risk matching. Customers appreciate our offering, which probably has the market best ratio of price to quality of service in the claims handling area. We are happy with the dynamic growth of TUW. Not only all the Treasury companies, or almost all the State Treasury companies are in TUW, but townships, hospitals and private companies are joining as well. TUW is an undertaking that is growing fast. We want to and we will earn strong profits on this undertaking. We are enjoying growth of insurance in Link4. Link4 is also innovative, its performance is improving and on April 11 it will launch a large-scale telematics solution. I'll talk more about foreign companies a bit later. As far as life insurance is concerned, we have record profitability in our life insurance segment and moreover we grew on the market that fell by almost 3%. So this is another piece of good news. As for foreign companies - we have a very strong position on the Lithuanian and Latvian markets. The businesses perform well, costs are under control and profits are rising. We are pleased with these companies and with our foreign operations. Of course, we would prefer our involvement to be reflected more strongly in the company's valuation, so we make efforts and keep our strategic goal, which is to generate more than 20% of the company's profit outside of Poland in 2020. I also believe that from your point of view, the analysts and the market, foreign operations ensure a better diversification of the company's business. As far as strategic metrics are concerned, I want to discuss the key metrics quickly to show you and prove that we have realized the strategy. In non-life insurance, we assumed a market share increase and now we are already one percentage point above, now we will revolve around 35%. According to our calculations, in non-life insurance this is the level that allows us to make the most of the economies of scale, in our sales channels and in claims handling operations. Actually, we are really satisfied with the claims handling expenses, even if, as you know, the regulatory risks, operation of claims law firms in the area of compensation for moral damages, had a very negative effect on the average costs and frequency of claims. We are hoping that our profitability will improve over the next few years in non-life insurance. Right now, measured by the combined ratio, it is 95%. We want to and we are convinced that this year we will achieve profitability in TPL and MOD motor insurance. I mean, we are already profitable in MOD; I'm talking about TPL. This year, measured by the combined ratio, our strategic goal is to be profitable across all products and all channels. This is our approach, a philosophy for insurance in general, and for property insurance in particular. We have made a commitment to you that we would reduce the Company's operating expenses by 400 million by the end of next year. The good news is that we've reduced them by about 80 million already. We are launching a new procurement policy. We have already cut costs significantly: we have announced group layoffs, which will also translate into lower personnel costs. We believe in and we maintain that cost-cutting goal even though the business has grown significantly. As you know, premiums have grown by double digits. In life insurance, we have very good profitability of about 25%. I believe that there is no insurance company in Europe, I know that there is none in Europe with such a strong profitability measured by ROE. What needs to be improved, and we will talk more about this in the investment activity section, is portfolio profitability above the risk-free rate. In terms of investments, we are counting on a future integration with Pioneer. For us, our competitiveness and our performance is measured by the amount of assets under management from customers and third parties. We uphold the strategic objectives in terms of assets under management and the level of assets from external customers. When it comes to health, this business performs better than we expected. We already have 1.3 million customers, 1800 outlets, we are good in using the sales network of PZU Życie, of life products, to sell health products. We believe this is a great product that is very popular with our customers. On the banking side, the strategy has been implemented with great success. These figures do not yet include Pekao SA. We have planned for 140 billion, and now, together with Pekao SA, there will be a bit more. Nevertheless, we believe that this is an implementation of the strategic goal that we made in the middle of last year, or even earlier, in March last year, when we presented strategic goals. We are pleased with the strategy of Alior Bank, because Alior Bank has proposed a new strategy, which puts great emphasis on innovation. I am the head of the supervisory board and we have worked on this strategy together with the management board. We believe that the solutions in the field of biometrics, data analysis, and perhaps also block chain in the future, will perhaps be applied at the level of the entire Group. And in this respect, Alior Bank's strategy is a good match with what we are trying to do as PZU – to be the most innovative financial group in our part of the world. We are also happy with how the price of Pekao SA shares has been performing so far. We think we have achieved good terms in difficult negotiations. We are also positioning ourselves to be able to benefit from the fact of being a significant major shareholder in Pekao SA, which we can use to our benefit to achieve synergies. Synergies are an additional upside. The proposed dividend from Pekao SA offers a dividend yield of 7%, which is more than we get in the investment area. We think there is a big strategic synergy effect in bancassurance in terms of investments, shared management of investments. So this is what we are preparing for, as we wait for the regulatory approvals from KNF and UOKiK. I want to say that these measures that are presented at the bottom of the slide are very important to us too. Solvency 2 in particular. We have announced plans to issue bonds, so everything is going as planned, as we have intended. We expected that we would have to issue subordinated bonds. This is not something that a regulator or the company's financial position would require; to the contrary: at A-, the company maintains the highest financial rating among all the companies in Poland, one notch higher than the sovereign rating. However we have also committed to you and to the market for the company to have the Solvency 2 ratio above 200%. That is the purpose of the subordinated bond issue. We are considering two markets: the Polish market and the Eurobond market. As for the ratios, which are equally as important to us, but are a bit softer, they include: the ratio of products per customer, which is a retail customer ratio, us versus the competition, here we also have some good news to convey to you in the further parts of the presentation. We will talk more about the changes in the structure of cross-selling, up-selling, cooperation between different areas of the company, the use of innovative solutions for CRM. So, to summarize the key issues about this year; first it was the acquisition of Bank Pekao SA, acquisition of Bank BPH. As you know, the acquisition of BPH, indirectly through Alior, has a positive effect on our results. High profitability in the individually continued group insurance segment. A positive trend in motor insurance, the intended significant increase in the market share and an even more ambitious pursuit of strategic goals, our key growth initiatives such as TUW and health, banks, foreign companies. When it comes to investments, you know how difficult this year was on the global markets. We had additional difficulties related, for example, to exposures to the Azoty Group shares, with write-offs on Armatura shares, plus the volatile yields observed on Polish securities, let's say "post-Trump" and because of the actions taken by the FED. We will tell you more when we get into details, but I would like to note first that the strategic project named Alpha, the new allocation project, has already made an impact. We had a few very successful financing deals, we have a very good Q1 in terms of the investment result. The effects of such strategic allocation changes are always delayed but eventually they will be reflected in the result. But we still claim that introducing a new, better global allocation, which will involve reducing for example the position in real estate, increased exposure to in fixed income in Poland and abroad, may improve profitability of the portfolio by several dozen percentage points. I think you are aware how much assets major Polish banks have ... You also must have followed the stock price of Bank Pekao SA, so it is a good moment to give floor to my competent colleagues. Tomek, could you say a bit more about the 4th quarter…?

Tomasz Kulik - Financial Director, CFO:

About the 4th quarter, there are two key segments: In group insurance, continued individually, there is a year on year increase; some could say it is insignificant, but we never said we wanted to grow at all costs. We want to grow profitably and this profitability in 2016 is definitely a confirmation of our plans. We are growing 1.3% year on year in terms of premium, but profitability is increasing significantly. Two more words about the premium side: type P group insurance went up by 1%, while we recorded a very significant growth in the health insurance segment. Here we really have double-digit growth. In 2016 it was more than 40%. This is the growth we are experiencing, but because of the low base it does not contribute as much as we'd like, to the gross written premium in the segment. If we look at the profitability of this business – and we know that the last year was very positively affected by a one-off event, which was a review of our assumptions about dismemberment and reversal of a provision of more than 200 million zloty. But I'd like to turn your attention to the very persistent and growing profitability of the insurance margin. Last year it was 19.5, in the previous year it was 19.2; this is something that is the pillar of these insurance products and something that we should look first, without focusing on one-off events. This is once again a confirmation that the individually continued group insurance business is consistently profitable, despite the fact that we are facing challenges of increasing the products per customer ratio and reducing the age of this portfolio. I would like Paweł to say a few words about the plans related to life insurance. On the other hand, even if remove the one-off effect from this equation, the whole margin of 22.6 is really something that we can be proud of. Paweł, do you have anything to add about that?

Paweł Surówka, President of PZU Życie:

I'd like to emphasize that this year we managed to achieve this profitability even though the competition is growing in this segment. We can see several players who are trying to enter the market at the same time, sometimes by using dumping prices. But we are not in this fight. We managed to grow while keeping profitability and we did it among others through new individually continued products, through riders to existing contracts that are margin-based, and also through health. And, of course, through strict cost discipline. This is naturally the key question whether this level of profitability can be maintained in the future. For us there are three vectors that we want to focus on to keep that profitability. The first vector is what Tomek Kulik said: reducing the age of the portfolio; after the first half of this year we will announce modifications to some of our group products; the purpose is to get these products more targeted towards the young people and I'd say to the mobile generation. The second aspect is further growth that is not possible in the strategic and mid-corpo segments, where we already are too big. But we will put great emphasis on growth in the small and medium-sized business segment, where we will focus mainly on bundling our services and having a comprehensive offer related not only to PZU Życie and health but also including property insurance elements, increasingly integrating our agency networks to this effect, to give them the whole range of our products. And the third aspect is the up-sell and cross-sell, which we want to do not only through greater cooperation with PZU Zdrowie, but through technology, by providing self-service possibility to customers, to add products under the existing contracts. And that is what I was saying in the past quarters: we want to increasingly look at those group customers as a huge platform where we can increase our product per customer ratio and this is something that we really believe could let us maintain such figures in the future.

Tomasz Kulik:

Another important segment: property insurance, motor insurance, which was reported on a lot last year because of the price hikes. I would like to remind everyone what happened on the market last year. In 2016 the price war had been going on for a few years; it had led to a situation where the market closed with a very, very big technical loss of almost one billion zloty in 2015. The price increases in 2016 were necessary to match the prices to costs and to ensure that the premiums to insurers were adequate. After 3 quarters of 2016, the technical loss was more than 600 million zloty. By the end of the fourth quarter it would be much more than that. How did PZU manage on such a difficult market? The market where the costs of claims are growing significantly year over year. First of all, we are increasing our presence on the market and we grab 3 percentage points of the market share on the property insurance market. This is a deliberate investment in the market, which we are expecting to cash on this year and in years to come. But at the same time, we were behaving quite differently when it comes to price increases; we were not the player that raised its prices by 50-60% as some of our competitors did. We were raising our prices gradually so that, at the turn of the 3rd and 4th quarters, we reached the optimum price point that, as you can see, allows us to present a declining combined ratio. And therefore improving profitability. Unfortunately, we are still unable to cross the profitability line when it comes to TPL. TPL remains, as they say, "underwater" for 2016, but we have significantly improved our profitability in this segment. We are getting better from quarter to quarter. As for MOD, we closed the previous year with positive results, so we are opening the year 2017 with a well-prepared portfolio. A portfolio that we want to maintain properly. The investment that I mentioned, these 3 percentage points, is not a frivolous and unintentional move. Let mi just remind you that, in motor insurance, we are talking about an increment over the base of more than 700 thousand customers, which is a really large number. We want these customers to stay with us for a longer time, profitably. Can we do it? We believe we can. Today PZU is perceived as one of the better providers in terms of value for money. So this is what the motor segment looks like. In non-motor insurance, we have a consistently profitable growth of business, in the mass segment and in the corporate segment. Last year, we had just one negative event in the mass segment, that is ground frost. The impact on the result is more than 230 million. Even with this one-off event, an event that we haven't had in our portfolio in more than 3 years, it has not been observed in our portfolio for a long time, our profitability is still at 80%. Without this element, we are a consistently profitable insurer in this segment, earning very high margins with a combined ratio of 75-74%. As for the corporate segment, we also have very persistent and consistently high profit margins that are stable and give us a good base for the coming years. The expenses that we have mentioned - this slide is another confirmation of what President Krupiński said. Reduced operating expenses, reduced expenses of the companies acquired in 2014, that is the companies acquired in the RSA deal: Link4, Lithuania, Estonia: cost savings of 5-9%. Of course, overall the costs are higher because we have started consolidating Alior Bank: the associated increase is 1 billion 200 million in the 2016 results. What I would like to note is that, on the one hand, PZU is growing in terms of volumes and premiums, which also increases pressures at the administrative side. But at the same time, we are able to, by saving and cutting costs, show much better efficiency ratios. The ratio of administrative expenses to earned premiums fell by almost eight tenths of a percentage point from 8.8 to 8.1 between 2015 and 2016. If this ratio is cleaned from the costs of the bancassurance channel - let me remind you that the regulations changed in this period; previously most of the broadly defined distribution costs were recognized as acquisition expenses; in 2016, for the bancassurance channel, we had to split these expenses and present them separately, broken down into administrative expenses and acquisition expenses. If we make an adjustment for this effect then our cost efficiency improves: from 8.7 at the end of 2015 to 7.5 at the end of 2016. So this illustrates the level of cost efficiency in the PZU Group.

Paweł Surówka:

When we look at the 2016 investment result, what is that we consider positive and what was negative? Among positives, under the Alpha project we managed to work out a new investment strategy for the PZU Group; consequently, we are entering the year 2017, for the first time in quite a few years, with a new asset allocation strategy, which is based not only on organizational changes where investment objectives are defined more clearly for all the members of this division, but we also have an allocation strategy that should improve our yield on this portfolio, while ensuring lower volatility and better matching with liabilities for an insurance undertaking. And above all, it is better structured in terms of capital requirements under Solvency. How can we achieve that? We want to achieve that by exiting some assets that do not offer appropriate profitability in the context of Solvency, such as, for example, real estate. We also want to reduce our exposure to equities, while moving this portfolio towards long-term investments. We also want to diversify this portfolio somewhat in terms of geography and risk. All these movements will make our investment result more predictable, also for you, and I believe that the new allocation, which we will be implementing for the most part of this year, because some asset classes that we want to modify must still be fulfilled and invested, so this year 2017 will be focused on converting this portfolio. But we can already see the first signs in this quarter. As for last year, this volatility couldn’t have been avoided. On the one hand, and this is the issue that you are perfectly familiar with, that is the exposure to the Azoty Group, which had a negative contribution of nearly 250 million zloty this year. The year before it had a positive contribution; the delta was almost half a billion zloty, year on year. There was also a revaluation or a sudden movement in Treasury bonds and generally interest rates in Poland at the year-end, which will obviously affect us, the fixed income part of our portfolio where we hold Treasury bonds; the mark to market was something that, especially at the end of the year, reduced our portfolio at the end of that quarter. It was not something that we could have avoided but it has already recovered to some extent in this quarter. Another thing that you could not have predicted and you didn’t know, is a few, I hope last ones, write-offs of the legacy corporate loan portfolio and here I believe that we have cleaned up the whole situation. As you can see here, higher gains on equity instruments, slightly lower income on financial instruments related to the fact that our hold-to-maturity Treasury bond portfolio is one billion lower, or 108 million loss on foreign exchange differences associated with our exposure to Euro under our bonds and the Azoty Group that I’ve already mentioned. If it was not there, the 2016 investment result would in fact be higher than it was last year.

Michał Krupiński:

Perhaps we could move on to questions now. Unless we should talk about the 4th quarter in detail. No, maybe questions. If you have any questions about the 4th quarters then we are at your disposal.

Michał Konarski, mBank:

I have a question about the motor segment. You have mentioned here that you expect the motor segment, the combined ratio to drop below 100% in 2017, but are we talking about some quarter along the way or do you expect the segment to become profitable in terms of the annual figures?

Michał Krupiński:

Certainly in annual figures, at least that is what we expect. And we believe it will happen somewhere between the 2nd and 3rd quarters. But as you know there is a delay in effects after you make a decision, also at the premium side. We are observing what our competitors are doing and our goal and I'd say philosophy is to be profitable in every product, and especially in this product. If you look at the data from last year, it is already good in MOD, while TPL needs improvement. But we also want to be profitable in every distribution channel, which means in our dealer and agent channels and in the multi-agency channel. Not only in our agency channel, in the direct channel. This is something that we are focusing on.

Michał Konarski:

I still have questions about the motor segment. What is your outlook for 2017? What I mean is, Do you want to compete with the price or will the prices stabilize? What were the price increases in 2016? Where is your "sweet point" in terms of the market share and prices?

Michał Krupiński:

We are confident that we are offering the best value for money. In particular, customers are satisfied with the speed of claims handling process, since PZU pays claims out quickly. We also have many innovative initiatives on the claims handling side. Such as on-line claims handling. There is an increasing number of customers who use these solutions plus the strength and credibility of the brand. And about your question whether we are competing with price? We do not compete with price. PZU is a premium brand, it is a high level brand and most certainly we do not have the thinking to compete with price. But we believe and we are under the regulator's regime, we are striving to achieve profitability in all the channels, also in the motor insurance business. So that is our philosophy. Also, Roger Hodgkiss has implemented many solutions on the Everest platform for new, more advanced pricing, and we are increasingly using census data. We are segmenting our customers better and the fact that we achieved 700 thousand – that was intentional. 700,000 new customers – this is also the result of us becoming more advanced in terms of this product. Plus we are up-selling. We have an excellent pricing team and we are also working on new solutions. We work with Link4, even though they have a completely separate pricing process, they are making their independent decisions. These are the Chinese walls, but they will also be implementing telematic solutions, as soon as April 11th, and we also want to use that. Tomasz, is there anything else that you wanted to add?

Tomasz Kulik:

I think we should add that we already have the preliminary market data for 2017 for those companies that report to the Polish Insurance Chamber (PIU). January, because this data is available, shows double-digit growth and I am not talking about PZU here, I am talking about the market. What is happening on in the market? Last year there still was a huge technical loss on TPL. This means that this old technical loss will have to be covered by the market, covered by an increase in prices. Today we are the a point where our prices are adequate to the expected costs. Therefore, we already have all the changes in terms of market structure, cost structure, structure and changes in the claims handling process already incorporated into price. Today, we do not have to increase and revise our rates any more. What we have to do, which is also our intention that we are pursuing, today we have those 700,000 new customers who came to us and who trusted us for the first time; now we must offer them a long-term relationship with us in a way that would be attractive for both parties. So, on one side there will be a customer who will still be a beneficiary of the scale, a beneficiary of PZU's lower operational expenses, which will translate to a rate that is lower than the one offered by competitors and we will be able to run this line profitably.

Michał Konarski:

So you can conclude that your market share will continue to grow in this segment in 2017?

Michał Krupiński:

First of all, we have excellent instruments and profitability analyses of respective customers and this is what we are using. We don't care about acquiring loss-generating customers. We don't have any ambitious target for increasing our market share. We have recognized that the company lost the market share and we recovered the market share. The market share that we currently have, especially in terms of motor insurance, gives us the comfort of benefiting from economies of scale. What is very important – in particular on the claims handling side. Our goal is to maximize profits for shareholders. So that is how we will make our decisions. In my opinion, the profitability of this sector can be achieved without additional premium increases this year. That's our goal.

Michał Konarski: Thank you.

Kamil Stolarski, Haitong Bank:

Good day. I have a question about the dividend, because this morning we had a comment from the President that it would be significantly above 50%. I understand that we are within the 50-80 range. So far, my impression was that it would be closer to 50%. So my question is whether it will be closer to 50 or to 80%. I don't know if you'd like to...

Michał Krupiński:

I think you have identified it well that we are moving in the range between 50 and 80%, but I cannot reveal any more details. We are considering a number of factors, actions by our peers. However we maintain our previous declarations that the company is a dividend company and an appropriate dividend must be retained. I don't think I will provide any more details at this stage, but my position still is that the dividend will be significantly above 50%. We consider the 50% as the floor. As you know, we can spend up to 20% on internal development and innovation. This year we will not spend the entire 20% – it will be much less. In the coming years, we want to put a stronger emphasis on investments in innovation. However, because of the Bank Pekao SA acquisition, going along our decision tree, which is known to you and is publicly known, we will be able to reduce the dividend payout level to 30% because of the acquisition. So there are no surprises here. It was a significant acquisition and everything fits within the dividend policy proposed last year.

Kamil Stolarski:

One more question about the subordinated debt issue. As far as I remember, there was a previous comment about the issue of 500 million Euro, and now it is 3 billion zloty. Should we consider this as an increase of that issue?

Michał Krupiński:

Naturally, we were reporting with a certain margin, because we have several possible options. First of all, we are not forced to issue subordinated debt. It is only a consequence of our market commitment to keep Solvency 2 ratios above 200%. Those are not regulatory requirements. Of course, this is what we want and we have a positive dialog with the S&P agency to maintain the rating. However we are also very comfortable about the possibility of keeping the rating at A-. About our options: we can refrain from issuing, we can issue debt in zlotys if the market has capacity enough, or issue it in euros, or issue it in both euros and zlotys. So, we will only be guided by the cost of the issue and our own needs for the issue. These all options are on the table, and nothing changes in this respect. Obviously, when companies publish or announce a debt issue, they do it with a certain margin, for example if it turns out that we want to issue the instrument in two tranches. If the conditions are good, perhaps if the price is very favorable, if the market conditions are good, then this amount will be closer to 3 billion.

Kamil Stolarski:

Thank you, I have two more questions, about the banking and investment businesses. The first question is about a base scenario for Alior Bank. For many reasons, because the stock price has grown and it seems that is already higher than your average purchase price, and because Pekao SA will soon join the PZU group. The question is whether Alior will remain as a standalone bank?

Michał Krupiński:

We do not really care about earning cash on cash on Alior. We want to realize profits measured for example by the internal rate of return. Perhaps in the beginning Alior was acquired for too high of a price. I'm talking about the first blocks of shares; I believe that the banking tax and a few other issues existing in the banking sector were underestimated. But that is history, I think, because of the good strategy and excellent results. As you know, last week Alior announced record high results historically because of the impact of the acquisition of BPH. We have a similarly positive perception of the lack of acquisition of Raiffeisen bank. This is why the Alior stock price has performed very well. Nevertheless, we have a commitment to the Financial Supervision Authority to be a long-term investor in Alior Bank. From our point of view, naturally if the transaction is completed, and I am certain that the Bank Pekao SA acquisition deal will close, Pekao SA will be a more strategic asset. That doesn't mean that we won't also pursue synergies for Alior Bank – while ensuring full protection of minority shareholders and in accordance with the principles of UOKiK and KNF. In particular, I am convinced and I can see the positive effects of drawing from innovation experience, which is there in Alior Bank. As you know, Alior Bank places a strong emphasis on that and what Wojtek Sobieraj is proposing is realistic. I have looked at those solutions myself and they are solid – I'm talking about blockchain, biometrics, data analysis. Those are all solutions that can certainly be used at the level of the whole Group in the future. Additionally, in the Vitelo fund, we will give an opportunity to our portfolio companies to roll out their ideas if we decide that those are good ideas, to roll them out for the entire platform and the entire Group. So there are strong synergies in innovation and in procurement, and so on. In the case of Pekao SA, we can see a greater potential when it comes to the bancassurance channel and this is what we are preparing for. We have a project team of advisors, so if the transaction is completed we will be ready to achieve synergies in bancassurance and in investments. But I would like to emphasize that did not acquire Pekao SA for synergies. I believe that with this proposed dividend payout ratio, the transaction perceived individually is financially beneficial for us.

Kamil Stolarski:

One more question from me about that business and the comment that you hope to integrate with Pioneer funds, a question also about the baseline scenario for that part of Pioneer, which remains to be purchased and whether or not you plan to merge Pioneer with PZU TFI.

Paweł Surówka

I believe that, for the time being, we should remember that the deal with Pekao SA must close. About TFI, KNF must still give their opinion, even if we considered such a thing. But we must admit that asset management is the one area where the opportunity for economies of scale and synergies is enormous, also considering the pressure that the entire market will be under, including the implementation of MiFID II and its translation to the Polish market. Hence we assume that there will be further pressure on the asset management market and it will force consolidation of that market. There are many good arguments for those two entities to tighten their cooperation, or perhaps even merge. But as I have said: Pekao SA will have to comment on that and KNF will have to comment on that. But I personally see many advantages, it would create a dominating asset manager not only in our country but also in our part of Europe, which would be able to take advantage of the market situation in Poland. And at the same time I would like to emphasize that our ambition is not to be the best asset manager in Poland, but to be a global manager operating from Poland. Also in this context, when it comes to acquisition, more and more managers, even international managers, are returning to Poland and the scale can also help us there. So I am assuming, you can assume, that this scenario is considered very intensely.

Michał Krupiński:

If we are talking about growth drivers for the investment result, the first one is project Alpha, which is already yielding results. We are expecting a very good investment result in the first quarter because of the market. There are several good transactions, such as, well... Allegro, refinancing of Play and implementation of the Alpha project. Talent acquisition is another driver. We have been talking to several managers, who want to return from London, New York, from other countries. As for the third question, that is the economies of scale after integration with Pioneer. We can also see interest from large global asset managers who are willing to offer us management mandates for CEE, so that is a positive sign. As for the additional drivers, there is the Savings Building Plan in the future. The group is very well positioned for this, especially if compulsory savings products become mandatory; it is really easy for us to sell them, for example through the life or group insurance channels. Plus the whole question of direct, ETFs and the transition to the application of passive strategies. So we are bullish in the asset management sector, even if globally it is quite demanding.

Mateusz Krupa, Erste Bank:

I would like to ask a question about your strategy for the banks. When we assume a scenario that KNF says in the future that you cannot have two banks in your group. Then based on the words of Mr. President, can we draw a conclusion that Alior Bank would be the preferred investment since Pekao SA is treated as a financial investment?

Michał Krupiński:

No, I did not say that. I believe the opposite is true. I believe that Pekao SA is more strategic because of the size of our exposure and because of the matching on the side of our customers. What I want to say, however, is that I don't want to speculate, speculate publicly about what we would do if KNF says this or that. We have obligations as an investor in Alior Bank and we have submitted our commitments for Bank Pekao SA. We believe we can introduce appropriate compliance measures, "Chinese walls", to fully comply with the competition principles and the rules of UOKiK and KNF, fully respect the rights of minority shareholders, while ensuring good management of both banks.

Mateusz Krupa:

Can you imagine a scenario, in which you exchange your stakes with PFR in the future, to ensure that two banks are not held in a single group?

Michał Krupiński:

Once again, those are hypothetical speculations. I would prefer not to address this issue.

Mateusz Krupa: Thank you.

Michał Konarski:

Excuse me, I have one more quick question about the dividend - are we talking about 50-70 or 50-80%?

Michał Krupiński:

Well, we are talking about the 50-100% range and, because of the acquisition, this range will be adjusted as needed. I would not..., we will analyze, at present we have no recommendation about the dividend. We will also refer to history. We don't want the company to pay a dividend lower than it paid out in the previous years, measured by the dividend yield for example. We will look at our peers, we will look at the financing needs for investment purposes, especially for innovation, and make decisions accordingly. Let's say we have some numbers in our heads and I think they are higher than the market has expected of us. But we cannot talk about that in detail.

Tomasz Kulik:

Perhaps I can propose a question from the Internet.

Tomasz Kulik:

I think we have really exhausted this topic. Gentlemen, when we are thinking about a dividend, we are really trying to ensure that the shareholders are the beneficiaries of PZU's growth and the results we are and will be generating. Accordingly, to support the deal, we are pursuing the subordinated bond issue. We have announced it and this information has been public since yesterday. But at the same time, we are working on reducing our capital intensity. So this is not just a matter of increasing our capital pool, but also of reducing, keeping in check the SCR so that it is as attractive for us as possible, while keeping the lowest possible cost of debt service. Reinsurance is one of such elements. In the 4th quarter we increased the capacity of our catastrophic treaty, which reflected positively on the reduction of SCR. And to answer to some extent the HSBC question from the Internet "What are the changes in the reinsurance program that can reduce the volatility of claims expenses..."; as a result, the events that we talked about for virtually the entire year 2016: 230-250 million of losses related to ground frost, crop hail, this will no longer be an issue to be discussed in the coming years.

Michał Krupiński:

Yes, I also want to speak about this, because, as you know, the company was affected by one-offs last year. One of them was the 400 million of banking tax; we've already talked about Azoty, write-offs, we had some legacy investment issues that required write-offs, such as Armatura, but also a few others, plus claim payments. For me as the president of the company, a situation where the previous result was slightly above 2 billion and there are claim payments of 250 million, this is a serious situation and, on my request, we have introduced new rules for reinsurance to avoid any such situations in the future as much as possible. So directly speaking, the reinsurance program is activated; let's say that we get a payment above a lower floor from global reinsurers. It requires a greater up-front cost. I am also considering my past experience, for example in the World Bank, where I watched the global time series related to catastrophic insurance. I worked with global reinsurers on a reinsurance pool among others in the Balkan countries, in Turkey, Mexico. My belief is that these climatic changes drive exponential growth in those time series. We collect a lot of information. I am meeting with the heads of other insurance companies, not only in Europe, and they also confirm this phenomenon, so we want to be more conservative in this regard. Because we cannot fully prevent a situation in which we have a similar problem that we had last year. The problem was that we had a harsh winter without snow; these things tend to repeat. We are also committed and we are working with the Ministry of Agriculture to popularize agricultural insurance. As you may know, the Ministry of Agriculture has a record number of subsidies to agricultural insurance this year. I believe this is a good time to popularize the concept of agricultural insurance. Among others, through TUWs. The ultimate situation, in which we are able to insure farmers under a mutual insurance relationship, this factor is at a record low 18% of farmers pay for the crops, so this ratio should be increased, to the benefit of the market and to the benefit of the insured. market and for the benefit of the insured. We are also working on catastrophic pools, on large catastrophic insurance events, which in Poland mean the flooding. This is the greatest risk from the Group's point of view. So we are working on the appropriate solutions with the Ministry of Development and the Ministry of Internal Affairs and Administration.

What is the second question about?

"How much do you earn on the invested money at the moment? How much will you earn on the investment portfolio after the implementation of Alpha?"

Paweł Surówka

This is something that we announced in the strategy and is also shown on one of the slides. Strategically, we are anticipating profitability of 200 bps above the risk-free rate and we are assuming that this is something within our reach, when we're talking not only about our bond portfolio but rather about the whole exposure and all those diversification activities and the increasing exposure to fixed income and also to infrastructure, which is where we want to go now. We expect that this is within our reach. At the same time, we will have better alignment with the insurance portfolio, a relatively lower risk measured by volatility of the IFRS result and also a better use of capital. We even think that these 200 bps can be exceeded to some extent, but in the long term this is the guidance that we wanted to give to the analysts. While we are at it, I must remind you that – because I feel that the question may lead to that – remind you that insurance products have an embedded investment rate, which is calculated in the insurance segment in the long term. It is not dependent, year to year, on the changes in the investment portfolio. So we have a different embedded profitability for the investment portfolio in the insurance segment and a different one on the main portfolio.

Michał Krupiński:

I could say it this way: We recognized that the results that we achieved previously are not satisfactory, given our risk appetite. The purpose of the Alpha project is to increase returns on the investment portfolio by several dozen of basis points, while keeping risk appetite at the same or comparable level. So I believe I can say that we are quite comfortable about this topic. Of course, much will depend on the global and Polish interest rate environment and on the global stock markets. But this is our intention, while keeping the same risk appetite at the group level, and we believe that the first effects of this project are already visible and will be displayed in the results for the 1st, 2nd and subsequent quarters.

Michał Krupiński:

Yes, we still have questions from the Internet.

Tomasz Kulik:

There is a question from Ipopema: Did the 216 million reversal of life insurance provisions refer to 2016 only or to preceding years as well?

Ladies and gentlemen, what happened in 2016 was a change in the assumptions regarding dismemberments, which are used to calculate provisions related to those risks. So this is a one-off effect, which affected mainly the individual continuation portfolio in 2016. This is a one-off effect, which will have no impact on the provision calculation method in the coming years.

"The large increase in administrative expenses in the fourth quarter. The consolidation of BPH does not explain the entire increase. The restructuring provision is 268 million, but according to notes to the financial statements, 200 is recognized in other expenses – so where is the remaining amount posted. What is the cost impact of the accounting change in bancassurance? What is the reason for the relatively weaker performance on the equity portfolio? Does PZU hedge its equity portfolio in investing activity?"

I will respond to these questions one after another. As for the 4th quarter, you may remember, especially those of you who have been with us for a longer period, PZU's expenses are subject to some seasonality, being much higher in the 4th quarter. That was also true in 2016 and it was not a surprise for us. What is important and what we pointed out is the declining ratio of administrative expenses to premiums. And I would like to ask you to look at it this way, because our portfolio has experienced a very strong growth. We've talked about this, sales have exceeded 20 billion. That is a portfolio that must be serviced. So we should not expect that such growth can be achieved for free. On the other hand, as we've shown you earlier and what was discussed by President Krupiński, we are implementing a cost-cutting program and this is happening. Regarding the change in the accounting treatment of bancassurance, what is the 4th quarter impact. I believe that this is a question about how we are presenting this amount. So this is a figure of approximately 130 million zloty for the full year, which is broken down into quarters. It is more or less one fourth of that amount. So we can see how it stacks up quarter to quarter, or compare it with 2015. What is the reason for the relatively weaker performance on the equity portfolio and are we using any hedges.

Paweł Surówka:

I can respond that the Alpha project overall, in the long term, anticipated a slightly lower exposure to equities. On the one hand, in view of Solvency II and the use of capital, equities prove to be less profitable and they also increase volatility, if you measure all our exposures as mark-to market. Therefore, not only in strategic terms in Alpha, we decided to reduce our exposure to equities a bit and we implemented this reduction in a highly volatile period, or expecting high volatility, before the US elections, partially hedging the portfolio. This however did not prevent us from taking advantage of the growth that took place in this quarter.

Tomasz Kulik:

There is one additional question from colleagues at Trigon, about the costs, seasonality in costs; we have already talked a bit about that. But there is an additional question whether or not the costs already include any provisions for group layoffs in 2017. The answer is no, they don't. The provision is recognized only after the management board makes the relevant decision in the form of a resolution. The resolution was adopted in the first quarter and therefore the costs of 2016 are not affected by this additional cost.

Michał Krupiński:

Well, are there any more questions?

Mateusz Krupa:

About the last one, does it mean that the provision will be recognized in the 1st quarter? Could you share any estimates?

Michał Krupiński:

Gentlemen, we are still negotiating and at this stage we cannot disclose any provision expenses, as if the FTEs had been specified; we are still in negotiations. We certainly want to reduce the cost of support functions, reduce headquarter costs, where we believe there are significant areas for improvement. We do not want the sales to suffer and, since the business has experienced strong growth, we do not expect any significant changes in claims handling. We also want to flatten the management structure. We believe that the structure should be flattened, because it might have been too excessive. These are the main directions, but I believe it is too early to specify and disclose any amounts.

Michał Krupiński: Are there any questions left?

Thank you very much, we're still in the green.

Thank you very much.