UBI Banca

"Consolidated Results as of December 31, 2018 Conference Call"

Friday, February 08, 2019, 14:30 CET

MODERATOR: VICTOR MASSIAH, CHIEF EXECUTIVE OFFICER

OPERATOR: Good afternoon. This is the Chorus Call conference operator. Welcome, and thank you for joining the UBI Banca Group Consolidated Results as of December 31st, 2018 Conference Call. After the presentation, there will be an opportunity to ask questions.

At this time, I would like to turn the conference over to Mr. Victor Massiah, Chief Executive Officer of UBI Banca. Please go ahead, sir.

VICTOR MASSIAH: Thank you, Madam. Good afternoon to everybody. I'll start this presentation from Page 4, where you have an executive summary of our results. Profit for the year, net on non-recurring items was €302 million and it compares with €188 million for 2017. Stated profit for the year €425 million versus €49 million in 2017, net of the positive effect of the badwill from the acquisition of the 3 banks which was €640 million that we had in 2017. We had stable capital ratios, including update of risk parameters. Liquidity coverage ratio and net stable funding ratio even excluding TLTRO are higher than 100 and leverage ratio is 5.45% phased-in and 5.27% fully loaded.

Just a piece of additional information, the capital ratios do not include any pro forma, and in particular, still do not include the positive contribution of the extension to the 3 banks of the advanced model that had some delay in term of authorization, but it is a question of when, and not if, and most probably, will happen very soon from now.

Over €90 million, actually it is a figure very close to a €100 million of cost saved year-on-year, notwithstanding continued investment in IT, digitization, rationalization of branch network and new layout of branches. Let me say that a very important component of this is coming also from the acquisition of the 3 banks, in terms of economy of scale that we could achieve in the past year.

In our opinion, there has been an outstanding performance in the recovery of credit. We had €2.7 billion decrease in NPEs during the year, which more or less is more than 20% of the stock, of which, 1/3 from ordinary internal workout. All of you remember that we have taken the decision from a strategic point of view not to sell, not to outsource the platform. And we are even more convinced of this decision after the delivery that was made in a very outstanding way from our people during this year. We have an improvement of all NPE ratios, gross, net, recovery rates, default rates, Texas ratio. And this obviously sets the basis for further improvement in 2019. The management will propose to the general meeting approval, an increase in the dividend to €0.12 per share. The dividend per share increases by 9% year-on-year and at the price level of this morning, the dividend yield is about 5.4% of closing share price at 7 February.

Page 5; we have a CET1 phased-in of 11.70% and CET1 fully loaded of 11.34% phased in and total capital ratio of 13.80% phased in and 13.44% fully loaded. This does not include the benefit previously foreseen within the year, but had a delay, of the extension of the model. Again, it's a delay, it's not an if, it's a when.

Page 6, focus on the NII. Given the fact that we have the new principle IFRS 9, we have tried in this table to make the comparison more possible among the different principles. So in the first component, the one that starts, as an example from second quarter 2017, 356 million in the yellow line, and 381 in fourth quarter 2018, you may see the contribution from business with customers without the IFRS 9 impact. This allows the comparison quarter-by-quarter since the second quarter of 2017. Again, the second quarter, because the first quarter did not include the 3 banks. And as you may appreciate, quarter-by-quarter, there has been an important increase in the commercial contribution to the NII.

One additional comment I would like to make is that the decrease in the fourth quarter is justified for €5 million by volumes of lending, but for €2 million because of lower contribution from UTP and past due. This minus €2 million, in my opinion, is good as it comes together with the reduction of the NPE stock.

The contribution of the financial assets is substantially stable in the last quarters. The effect of IFRS 9 is isolated and amounts progressively to 17, 22, 22 and 23 million. What is relevant also is that there is an increase in the interbank negative from minus 2 to minus 6 million Q/Q, minus 4 million, due to increased liquidity deposited at the ECB and greater activity in repo transactions with institutional counterparts. This goes together with the building up of what will be reimbursed for the TLTRO. But again, this TLTRO is not causing any particular problem to the net stable funding ratio. Again, we confirm that the net stable funding ratio result excluding the TLTRO will anyway be higher than 1, so perfectly in line with the request of the authority.

But mostly, there has been resilience in the commercial business. It's shown in the bottom of the slide where you have a customer spread that actually has increased in fourth quarter versus third quarter, 173 bps versus 172 bps in 3Q, in particular thanks to the cost of funding where there has been additional reduction. This is notwithstanding the crisis with the institutional market almost closing. So altogether, I think it's been a very good example of resilience under the crisis.

On Page 7, you may appreciate that, altogether, net performing loans to customers have been more or less stable while the stock of non-performing has reduced. In particular, as you may see, in terms of billions of euro, the net bad loans were €3.52 billion in January 2018 and are €2.77 billion in December, with a decrease of 21.4%. The unlikely to pay have been decreasing by 16.8% and the past due have halved. This is very important because this means that there is a good discipline at the beginning of the crisis which also influences, as we will see later, the impacts on the cost of credit.

No particular new messages on the financial assets. We have, more or less, a very stable situation. The message indeed is that we have not been doing any particular maneuvering or increasing our portfolio in terms of Italian Govies, even at the beginning of 2019. So we confirm our pace of driving down to 50% the component of Italian Govies. The only thing I can say is that, given the fact that compared to the industrial plan, we are below what we were supposed to have in terms of total financial assets, we have room for flexibility in the process.. And so, if any opportunity comes, we can take it but that's different from the strategic vision that remains the same.

On Page 9, we have a deep dive in the net fee and commission income. What went down from the fourth quarter 2017 to the fourth quarter of 2018 are the upfront and performance fees. As you may see there has been a very important decline, while on the opposite, the management, trading and advisory services have been substantially resilient. The other thing that has been resilient are the banking-related commissions notwithstanding the fact that these have an additional weight to carry, which are €6 million of synthetic securitization fees which had a negative contribution and were not present in the fourth quarter of 2017. So if we compare fourth quarter 2018 versus fourth quarter 2017, net of the securitization fees that have nothing to do with the normal commercial business, we have an increase in banking-related commission.

We have a stable increase in the management, trading and advisory service and we have a lower contribution by upfront and performance fees. A detail of the upfront is available in the bottom of the slide. So altogether, we have a sustainable set of results and this, in my opinion is true for the fees but also for the NII. There are no one-offs, it's a very sustainable platform on which to build for the future.

Also on the side of costs, we have in my opinion good results. As you may see, the quarterly reduction year on year has been minus 3.3%, €616 million versus €638 million. Since we cannot compare the full year, we have anyway, made a quarterly average and the average for 2017 was €635 million, whilst it is €612 million for 2018. So even if you make this type of calculation, you have something near 3.5%-3.6% decrease yar on year which is very encouraging. And, if I may say, this is not over. You have then the detail of the single components of operating costs that I leave to your reading.

In terms of headcounts, we continue with our trajectory. In terms of domestic branches we are already where the Business Plan was landing in 2020. And in terms of headcounts we are very close to it. And this is why we are saying that from the cost point of view as a matter of fact, we have already achieved what were the targets of 2020.

Then I would like (on Page 12 which is new compared to our previous presentations) to show that it's true that we've been, let's say, keeping a very, very strong control on the IT development cost, but this does not mean that we have not been investing in innovation. In the red component of the “change the bank” part of the slide, you have the component relating to “innovation and business development” which will again increase significantly in 2019. So on one side, we are reducing costs, on the other side we are increasing the component of the costs that we dedicate to the innovation.

On Page 13, you have the analysis of where we are in terms of gross NPEs on total gross loans. We have a ratio of 10.42%. This compares with the peak of 15.51% in September15, and this is 5 percentage points lower, with a reduction of almost 30%. We confirm what we said in previous conference calls, we expect to cross the 10% level of gross NPEs and enter the single-digit world already within the 2019.

And let me add here something that I think is relevant, we have read some comments regarding the fact that we have a cost of risk in the fourth quarter that was higher than expected. The most important component of this higher level, is the fact that we have posted an additional component as a probability of a potential sale.

And this potential sale regards 2 specific specialized buckets of NPEs, one in leasing and one in factor, that are, in this moment, under negotiation. I cannot give details now because the negotiation is confidential, but this encourages us, together with the regular pace of what we're recovering through internal workout, to make a stronger statement regarding entering in the single-digit NPE ratio at quite a fast pace.

The Texas ratio, it's on the top right of the slide, is at 85.3%. So it's already beating what was the original target for 2020. As you may see, both on operating costs and on credit quality, we have achieved or almost achieved, not the target of 2019 but the target for 2020. And this is one of the reasons why we envisage the opportunity to start on a project for a new business plan.

Let me comment at final component of Page 13 which is the coverage ratio. As you may see, the coverage ratio has slightly declined, without write-offs, while it has recorded a slight increase with the write-off.

I would like to make a comment on this, we have sold an important NPE portfolio under GACS and in general terms under FTA. And I think it's visible to everybody that the component of unsecured was pretty high in what we sold. And I think that the resilience of the level of coverage notwithstanding the sale of unsecured components, more highly covered, was important to the market.

An additional good news came from the relevant improvement in default rates and in gross inflows from performing. I am on Page 14. In the last quarter, the default rate was 1.38%. You have to compare with the Business Plan target of year 2020, where we were expecting 1.4%. So again, in the last quarter of 2018 we are beating the 2020 expectations in the Plan. Let me also stress the point that the same figure was 1.85% in the first quarter of 2018, including the 3 banks that we acquired. So these are default rates in the new perimeter.

In terms of new gross inflows from performing to NPEs, we are seeing very important decline quarter-by-quarter in the bottom part of Page 14. I leave to your reading the single figures, but I think it's very relevant to compare the €510 million of the fourth quarter of 2017 with the €289 million of the fourth quarter 2018.

On Page 15, we give a clear demonstration of why we are keeping the platform In the fourth quarter you're seeing an increase in recovery rates versus the third quarter, 11.2% versus 9.2%. The recovery rate anyway increases year on year, both on total NPEs and on bad loans.

Last but not least, the business outlook. Why are we saying that we will recommend to the new Board that will take place in April the definition of a new business plan? The reasons are very simple. While on the cost structure and the cost of risk structure, we are already there or almost there. So in a way, the plan is old for a positive reason. On the revenue part, we have market conditions that are radically different from what was foreseen in the business plan.

In the 2017 Business Plan , the forward rates that we took to make .our forecasts, were discounting a slow but positive growth in the market interest rates, which were seen slightly positive during 2019. Today, the market rates are still where they were, at minus 0.38%, minus 0.40%. This is a clear, clear change in the market rates and the same can be said for the credit spread in terms of Italian govies, which was 130 in the Plan, while today, it's around 280.

Given these 2 relevant conditions plus a slower growth in the GDP, in our opinion, again, it's important to redesign a new business plan, with a time time horizon at least consistent with the time horizon of the new governance. Once the new governance has taken place, we expect the plan to be ready within the year and hopefully in time for the first year of budget, which should also be the first year of plan, year 2020.

Altogether, we are saying that operating expenses and credit quality are better than expected and that, notwithstanding higher complexity on the revenue side, we expect to generate a positive result in terms of growth of the normalized results in 2019.

Altogether, if I may summarize the year, the growth in terms of profitability made in 2018 versus 2017, notwithstanding a very bad second part of the year in terms of market conditions, has been significant; components of these results are sustainable and a strong platform for additional growth. There will be growth in normalized profitability in 2019. In the meanwhile we will work or at least we will propose the new Board to work on a new Industrial plan with a time horizon consistent with the time horizon of the new Board. Thank you for your attention. I'm now ready to take questions.

Q&A

OPERATOR: Excuse me; this is the Chorus Call conference operator. We will now begin the question and answer session. The first question is from Azzurra Guelfi with Citigroup. Please go ahead.

AZZURRA GUELFI: Hi, good afternoon. A couple of questions. One, on the funding costs. Can you share with us what you think are the moving parts for 2019 and how the mix could affect these and if you see any potential headwinds coming also from the MREL level? The second one is on capital. You're very regular in updating your IRB model and you had an impact again this year. Can you give us some indication what could be your TRIM impact, given that the process has been going on for longer now and maybe you have more visibility? The last one is on NPLs. We have seen peers receiving letters from the ECB on their SREP, an indication about the need to improve coverage over time on position on the stock of NPLs. Your coverage is among the lowest, and I know you always explain why, but do you feel that there will be the need to do more disposals, and maybe look also at unlikely to pay or just the organic workout and the selective opportunistic disposal would be enough? Thank you.

VICTOR MASSIAH: Thank you, Azzurra. I'll start from the last one. The answer is that we do not expect - and actually, we made already a formal communication to the market - we do not expect a particular impact from this letter on the current provisioning. Because the way we see this pattern is such that we think that it's consistent with what we're already doing as a mix of regular provisioning, normal recovery and opportunistic sales. And we said before, these actions altogether allow us not to see any particular impacts from the request of the ECB.

Regarding the second one, the TRIM we're not expecting any particular impact. And in terms of regular parameters update, we'll stick to the discipline. As I said before, we had a delay on the authorization for the extension of the internal model to the 3 acquired banks' clients. But let me say that I'm expecting a CET1 ratio at the end of the year higher than the CET1 ratio currently in place, notwithstanding that obviously we will continue to update our historical series. We will do what we are required to do. But I think that a combination of what is coming on the positive side and, obviously, self-financing, will allow us to benefit in terms of CET1 growth.

Let me remind you also that compared with industrial plan again, there was something above 12% of CET1 ratio by the end of 2019. But that was together with a spread of a 130 bps. Do not forget that we are missing more or less, 60 basis points because of the spread in terms of a negative AFS, which I think was the impact until now. So we are not at all inconsistent with what was the Plan. And if something good happens, we could even be above 12%. Let me say, I would expect above 12%, if some positive correction on the spread would come.

In terms of funding costs and MREL, let me speak a bit first of all about MREL. I can give the message that we have no problem to be within the expectation of the MREL already during 2019. So I don't see this as a problem. In terms of cost of funding, we expect no particular increase at all, notwithstanding market conditions, because we have enough internal funding and internal tools. Just to share with you, in the second half of 2018, we issued more than €2 billion of retail bonds. I'm not saying that we are in love with the retail bonds, and actually I'm saying that if a window of opportunity even tomorrow morning would come, we have no problem to go straight to the wholesale market.
this year, We have more or less, €4 billion of retail bonds expiring, which we can renew should the markets remain difficult. Again, this is not the strategy. The strategy is to go institutional but, obviously, at a reasonable price. Did I miss anything from your question, Azzurra? Maybe I...

AZZURRA GUELFI: No. Thank you.

VICTOR MASSIAH: Thank you, fine. Thank you, Azzurra.

OPERATOR: The next question is from Riccardo Rovere with Mediobanca. Please go ahead.

RICCARDO ROVERE: Yes. Good afternoon to everybody. A couple of questions, maybe 3 from my side. Getting back to funding once again, if I look at one of your slides where you show all the maturities that are due in 2019, it's a fairly large amount, if I sum up institutional and retail bonds. Now given that the loan growth, given the Italian economic situation is not exactly, let's put it this way, stellar, do you really need to issue all this amount of money over the course of '19 or could you eventually issue less than that? This is the first question.

The second question I have is on your press release, you also mentioned that the risk cost in the fourth quarter was affected by a potential opportunistic disposal, but also by an update of the parameters of the internal models, which, I believe, must have changed the lifetime of expected losses under IFRS 9. Now if that is the case, would you be able to share with us what is the amount related to the updated parameters? And if there is any impact from the update in the parameters, is this impact already incorporating anything that should eventually come over the course of 2019, meaning that you have included a lower GDP. If the GDP does remain, more or less, as you have incorporated in your models, basically, you should not add additional burden over the course of '19? And then on the models and on risk-weighted assets, it's not clear to me what you expect...when are you expecting the internal models for the 3 banks? And on IFRS 16, do you expect any material impact? Thanks.

VICTOR MASSIAH: I'll try to help you regarding the components of the unexpected additional cost of risk. I would say half is the model update and half is the probability component of a potential sale in 2019. Regarding the impact, when I spoke about forecasts regarding the CET1 at the end of 2019, they are including these effects. In terms of...what was, excuse me, what was the last one, Riccardo?

RICCARDO ROVERE: The first question actually was on the funding, if you really needed to issue all the maturities that are shown in the slide.

VICTOR MASSIAH: Yes. In a way, you're right. We could even do a little bit less than what is expiring. I'm not wishing it, of course, in the sense that I wish to have a problem on the opposite way. This would mean that the economy is going a little bit better. But you are right, don't forget that issuing institutional means for us to be able to maybe repeat the very good performance in the asset management component of last year. Let's not forget that last year we have beaten the market, both for mutual funds and on insurance, and this was allowed also by the fact that in particular, in the first part of the year, in the first 6 months, we were able to piggy back on retail bonds expiring to offer different types of products, of course, consistently with MIFID and other regulation. This obviously is a degree of freedom that we wish to have also for 2019. So again, if you ask me, do you have any constraint to issue exactly the amount that is expiring, the answer is, no. You are right, Riccardo. If you're asking me, what would be your favorite mix, my favorite mix would be an important component of the funding in wholesale funding even if it's a little bit more costly because on the other side, I will have a degree of freedom to use some of the resources coming from the retail funding to offer additional, mutual funds and insurance products.

RICCARDO ROVERE: Thanks. If I just put in my small second follow-up on the extraordinary component, I'm not even going to insist on what the amount is and actually I don't care. What I'm more interested in understanding, because this is also something maybe new for all of us, the way IFRS 9 works, now when you update the models and you plug a weaker GDP, okay, in your models, this had an impact in your Q4 credit losses for whatever the number is. Is this impact charged all in a quarter or is this impact something that will be spread, will continue to exist over the course of 2019?. Because I might be wrong, but I could imagine that if in the models where you're running on, I don't know, 2% GDP, whatever the number is, now you plug 1% GDP, that increases PDs, LGDs, everything, okay. There is a sum, an amount of credit losses emerging from the models. And I just wanted to understand the way it works. Is everything charged in a quarter or spread across the lifetime of the loan book?

VICTOR MASSIAH: Clear now. Sorry, I misunderstood before. These scenarios that are not charged in one single quarter, are spread in time, but at the same time, believe me, this is conceptually right. In terms of materiality of this impact it's very, very, very marginal. Consider that in your example, if you were going from 2% GDP to 0%, this would be, maybe, material, but in our example, in our industrial plan, we have 0.9% GDP growth in the original plan and there might be 0.6%, 0.5% in the update. So it's not so relevant. And anyway, GDP is still positive. So the impact is not material. But conceptually, it's what you described. The answer is it's spread, but you can have corrections in time, because components can be volatile. So you may have something that goes in a certain way and then 2 quarters after, it corrects itself. So it goes for the good and for the bad and the technique is to spread it over time, not to have roller coaster effects.

RICCARDO ROVERE: Okay. Now it's very clear. Thanks.

VICTOR MASSIAH: Thank you.

OPERATOR: The next question is from Hugo Cruz with KBW. Please go ahead.

HUGO CRUZ: Hi, thank you. So my question is, you kind of...sounds like you kind of implied that if GDP growth actually goes to 0, that's where it could have a material delta. I know that consensus is now around, I mean, 0.2%, 0.5%. So .can you give some sensitivity if, for example, the growth was 0 or minus 0.5, what could be the cost of risk? And also, you implied that you can beat the budget. I think the current or the previous target was 63 basis points for cost of risk. Do you have a new number in mind? And then finally, can we talk about tax rate as well? That's very hard to forecast. Again, if you have some numbers for us, it would be very helpful. Thank you.

VICTOR MASSIAH: Please take this very carefully because it's a very, very rough estimate, but I'm ready to share because, again this is not something that it's so material, even in the worst case going below 0, you are talking on yearly base of €15 million. So as you see, it's not that relevant on a cost base of 500 or something. Did you get it, Hugo?

HUGO CRUZ: Yes. So you are saying basically the cost of risk could go up by another 15 basis points.

VICTOR MASSIAH: No, I'm talking €15 million, not 15 basis points.

HUGO CRUZ: 15 million. Okay.

VICTOR MASSIAH: In terms of basis points, this is 2.2-2.3…

HUGO CRUZ: Got it, okay.

VICTOR MASSIAH: Hugo, you were asking something more?

HUGO CRUZ: Yes guidance on your P&L tax line, because, obviously, it's very hard to forecast. There might be some DTA absorption. So if you could give some updated thoughts on that?

VICTOR MASSIAH: Yes. On the tax rate, I understand it was difficult for you, because it was difficult for us in the sense that we had to wait until the last minute what were the rule in terms of the last government maneuvering. Now, what happened was that, the losses that were generated by the first time adoption until the previous regulation were considered 100% under the year 2018. Under the new maneuvering you have to amortize these losses in 10 years, so it grows 10% each year. And this has caused a positive situation in terms of the possibility to use DTA.

Without the DTA the tax rate usually that we are floating in as per today is something in between 30 to 33, 35 recurring percentage points depending on the single specific situation. For future usage of DTA, we have to wait for the new business plan because it depends not only on the single year but on the expectation of the future profitability.

HUGO CRUZ: Okay. Can you tell us how much you know, DTAs you still have deducted from capital and how much you have off balance sheet?

VICTOR MASSIAH: Deducted from capital we have €350 million. So if you like, in common equity basis point, this is more or less 60 basis point . Again, I want to stress, we do not calculate pro forma in the common equity. I want to restate it, 11.34% does not include these DTAs, even pro forma.

HUGO CRUZ: Understood and off balance sheet?

VICTOR MASSIAH: Off balance sheet. Well, let me tell you that altogether, we have a potential of above €650 million, €700 million.

HUGO CRUZ: Okay, perfect. Thank you.

VICTOR MASSIAH: Thank you.

OPERATOR: The next question is from Domenico Santoro with HSBC. Please go ahead.

DOMENICO SANTORO: Hello, hi. Good afternoon and thanks for the presentation. Can we come back just for one sec to the question of the colleague on the IFRS model, that I found very interesting to be very honest with you. So we understand that there was a change in the PD in your model…in the GDP assumption that has, of course, also changed the PD implied in the expected loss? And this triggers also some internal move in the Stage 1 into Stage 2 and Stage 3 loans. And to which extent we should have a material GDP contraction in order to see reclassification among the classes. This would be very interesting to have an answer on this? And on the ECB addendum instead, we understand from your press release that there is no significant impact on capital and provision, but from the outside, it's a bit difficult for us to understand the mechanics behind. So why is there no material impact, is it due to some remedial action that you have in your estimates, or should we think about restructuring loans are not included or should we look at write-offs? Can you explain us, why there is no material impact on your capital as other Italian banks have highlighted as well? Thank you very much.

VICTOR MASSIAH: On the IFRS 9, your first question, we already said that even going below 0, we have an almost immaterial component. Honestly, I don't know what to say more in the sense that, I don't think there is any value in saying how much would be the impact of minus 4%, minus 5% GDP, frankly speaking. I think that the answer I already gave was significant. If we have €15 millions if we go below 0%, I think the answer is there.

Regarding our communication and understanding the mechanics. Honestly, I had a problem to understand the mechanics of the estimates that went public in that period. For example, I've seen estimates, saying an impact of 2 billions regarding UBI Banca, but then I went to read, there was no component of non-performing loans going back to performing, which actually happens. There was no component concerning the regular pace of yearly provisioning. So it's not to us that you should ask the question. It's to those who made those estimates that I think, in a couple of cases, forgot very significant components that do completely, almost zero, the impact that was estimated.

DOMENICO SANTORO: Okay. Thank you. Sorry, Can I just ask a follow-up on this? Are the recommendation of the ECB already clear to you and all the Italian banks or is part of a conversation...discussion that will become more clear during the year?

VICTOR MASSIAH: What is today a recommendation to us is pretty clear, even if we have still not received the final formal SREP. I cannot answer obviously for the other banks. But as for today, it's clear and our statement is strong. There is no impact.

DOMENICO SANTORO: Okay. Thank you very much.

OPERATOR: The next question is a follow-up from Ricardo Rovere with Mediobanca. Please go ahead.

RICCARDO ROVERE: Yes, two if I may. The first one is, again, sorry, on DTA. It is something that is a bit difficult for me to understand. If I remember correctly when I looked at your first half report, and correct me if I'm wrong, I remember that the amount of DTAs that were deducted from the capital were not materially different from the ones in December. So what I understood from looking at your first half report is that the losses generated by IFRS 9 first time adoption, for some reasons, you know, were not kind of recognized as DTAs because I would imagine your probability test was not considering them recoverable over a reasonable period of time. I really don't understand now what has changed, you know, why all of a sudden, you know, 6 months later, you know, these DTAs become recoverable. I understand they are of different nature, tax loss carry-forward, timing differences now. But the underlying fact should have not changed. Are those recoverable or are not recoverable?

VICTOR MASSIAH: Riccardo, sorry to interrupt you. But the underlying facts are changed, not on the FTA part, but on the way the tax office is considering that loss. Until the maneuvering of the government which came at the end of December, so was not at all known in the first half of the year, until that moment, until December, there was a full loss recognized by the tax office within the same year. So if I am losing 100, I am losing 100 for the tax office. Since that was, from the tax office point of view, a total loss there was no way to use the DTA because I didn’t have a profit. Then comes the maneuvering of the government and the government says, no, it's not 100 that you have to deduct but only 10, because you can deduct that 100 in 10 years. So since I don't have any more 100 of loss, I have only 10 of loss, altogether, I have a profitable year and since I have a profitable year, I can use some of my DTAs. Is it clear now?

RICCARDO ROVERE: Oh, it's a bit more clear. Although still,given that tax loss carry-forward do not expire, you know, in theory they never die. I don't see the difference.

VICTOR MASSIAH: Riccardo, you're right. You're not wrong when you say they do not expire. In fact, we're not saying they will disappear. We are saying the distribution of these DTAs in the future will depend on what we see in terms of new profitability distribution in the future. And secondly, depending obviously on the continuous change of regulation, what was a rule a day before was not anymore a day after, and also in terms of DTAs, it's not only 1 year but many years of time horizon to look at, to plan and use the DTAs. And that's the only reason why. But again, they do not disappear, they do not expire for sure.

RICCARDO ROVERE: And then as a second thing, much less complicated. With regard to the number of headcounts, you are more or less 2,000 people, let's say 1.800 people away from your 2020 target. How many people should leave the group over the course of 2019, if you can share this number with us?

VICTOR MASSIAH: Riccardo, I'm sorry, but we have always to share with the unions everything. What was in the industrial plan in figures 2019, is for sure a target. Maybe there will be something more, I cannot say more because, obviously there are procedures.

RICCARDO ROVERE: I understand, thanks.

VICTOR MASSIAH: Thank you.

OPERATOR: The next question is from Ignacio Cerezo with UBS. Please go ahead.

IGNACIO CEREZO: Hi, good afternoon. Thank you for the presentation. Three questions from me. And the first one is, if you can share with us the front book, back book of the retail bonds you are issuing? The second question is in terms of asset quality...

VICTOR MASSIAH: Ignacio, I'm sorry, it's not a very good sound. So could you repeat, please?

IGNACIO CEREZO: Yes, sorry. Yes, I was after the back book, front book of the retail bonds you're issuing versus the ones which are maturing last year or this year? The second one is, in terms of asset quality, I know it's probably a difficult question but then, what kind of economic correction do you think we need to see NPL inflows accelerating again? And the third one is related to the 12% core capital ratio by the end of the year, if you are incorporating any type of risk weighted assets headwinds coming from regulation? Thank you.

VICTOR MASSIAH: Well, first of all, the 12% I was talking about was including some positive correction on the AFS reserve, so on the Italian Govies. I want to be double clear because I don't want to be misunderstood. If we don't have that, we can get close, but we cannot get there.

Second, regarding the economic correction. Well, usually history tells us that if you have a couple of consecutive years of negative growth, in that case it's almost mathematical to have an increase in the default rate. But do not forget that the average strength of today's corporates is much, much higher than what it was in the previous crisis, because we went already through a very strong Darwinist approach, many, many weak players are not with us anymore.

You can double check this, looking at the distribution of the quality of the ratings of our portfolio of performing loans, it is much, much, much better than what we had in 2007 before the beginning of the crisis. So it's something that must be very severe to see something new really happening. Let me tell you that, anyway, one thing is saying this, one thing is the confirmation of this. I made a call to the Chief Lending Officer to understand how January was, and January I was told was a good month. So again, we don't see at the moment any sign at all. .

In terms of retail bonds, I'm not sure I understood, but what we have is the following. We have, as I said before, more or less €4 billion of retail bonds expiring in 2019. These are all renewable, if needed. Exactly as we have renewed in the last 2018 half year a little bit more than €2 billion. So renewing €4 billion is not a problem at all.

IGNACIO CEREZO: I was more referring to the cost of the new issuance versus the cost of the maturity?

VICTOR MASSIAH: Yes, the cost…be aware that as for the second half of 2018, we've been able to replace this at more or less at the same cost of what was expiring. You can see this is demonstrated in the cost of funding, where we have actually decreased the cost of funding by 3 basis points in the last quarter and the quarter was already critical, because institutional funding was closed and we were renewing the retail bonds. So this is not in an hypothesis, this has been shown already by what happened in the fourth quarter. So we don't see as per today an increase compared with what is expiring. Obviously, this is at the current market condition, Ignacio, it's obvious that if spread goes to 350, it's a different story. But as per today, this is where we are.

IGNACIO CEREZO: Thank you very much.

VICTOR MASSIAH: Thank you, Ignacio.

OPERATOR: The next question is from Anna Adamo with Autonomous Research. Please go ahead.

ANNA ADAMO: Hi, good afternoon. Thank you for taking my questions. And in relation to asset quality, I think it will be extremely useful if you can give us the split of NPEs between secured and unsecured. And also tell us which portion of your NPEs has an old vintage. In other words, how much of this has been classified as NPEs more than 7 years? And then the second question is just on the SREP. Have you already received an indication from the ECB? Thank you very much.

VICTOR MASSIAH: Regarding the gross NPEs, 75% of the gross NPEs are assisted by guarantees.

ANNA ADAMO: I wanted to ask also about the proportion of NPEs which has an oldvintage?

VICTOR MASSIAH: Well, let me give you a couple of numbers. 40% of our NPEs are younger than 2 years, and 74% of these are younger than 5 years. So what is older than 5 years is 26%, of which 14%, 5 to 7 years; and 12%, over 7 years.

ANNA ADAMO: Very useful, thank you.

OPERATOR: The next question is a follow-up from Hugo Cruz with KBW. Please go ahead.

HUGO CRUZ: Hi, thank you. On the NII, so we kind of know performing loans are flattish, funding costs are not going up, the commercial component is still falling, so it sounds like loan rates are still falling. Banks are supposed to be re-pricing their loan books. So is this enough of that? When are we going to start to see a benefit from re-pricing? Thank you.

VICTOR MASSIAH: Don't forget that the volumes .are stable also because we started a re-pricing policy in July. And let me say, if I may, not everybody was thinking the same way in the market, so we had, let's say, also to suffer some, let's say, unsuccessful offers in terms of lending activity. What is now happening in my opinion is that in terms of medium long-term, the corporate lending pricing on new origination is already above what was expiring for most of it, not all of it, but most of it. In the mortgage industry, it's a little bit different, still not there but going towards there. So almost there on corporate, getting closer on retail. This is the answer.

HUGO CRUZ: Okay, and is everyone kind of re-pricing now? Or there are still some disruptors?

VICTOR MASSIAH: Hugo, of course, I don't have the full picture of it, but frankly speaking, I see the situation improved compared to what it was in the third quarter and even at the beginning of the fourth quarter. The last weeks of the fourth quarter and this January see the situation improved. Obviously, we can observe many things, we cannot observe everything, but it looks like it.

HUGO CRUZ: Okay, thank you very much.

VICTOR MASSIAH: Thank you.

OPERATOR: The next question is a follow-up from Riccardo Rovere with Mediobanca. Please go ahead.

RICCARDO ROVERE: Sorry to abuse of your time. I just wanted to get back one second to the split you provided between secured and unsecured. Would you be in a position to tell us what portion of the NPLs of the sofferenze is unsecured?

VICTOR MASSIAH: I don't have this with me now. But I'm not expecting such a huge difference. Because this is for the whole NPEs, so I'm not expecting such a difference. I'm sorry; I don't have it with me now.

RICCARDO ROVERE: Okay, it will be fine. If we assume these are more or less the same...

VICTOR MASSIAH: Just a second. The Chief Lending Officer is confirming that what you apply to the total NPEs is more or less applicable to the bad loans only. So you have more or less the same proportion.

RICCARDO ROVERE: Okay, fine. So okay, now, given that you have just recently sold €400 million of NPLs and factor-in 0 impacts, actually it was...if I remember correctly, it was mildly positive...

VICTOR MASSIAH: It was a little profit, yes.

RICCARDO ROVERE: I think that's...exactly, it was a little profit. Given that you have roughly speaking, €1.3 billion, €1.4 billion of NPLs unsecured, unless you tell me that you have sold the jewels of the crown within that portfolio, why don't you just sell the unsecured, if you don't suffer any material impact on your equity?

VICTOR MASSIAH: It's apparently an easy statement. But actually since we made a little profit, and since I'm always convinced that the guys who are buying are not stupid, let me see if I can make some more profit myself.

RICCARDO ROVERE: Okay, got it.

OPERATOR: The next question is from Alberto Cordara with Merrill Lynch. Please go ahead.

ALBERTO CORDARA: Hi, good afternoon. Just a small point. On the liquidity coverage ratio we are 100%. I don't know if you can give us a bit more clarity because LCR over 1 is quite obvious. So I don't know if you can give us a bit more of an idea of the average LCR in the quarter or a bit more of a precise disclosure on this issue. And then on the MREL, I don't know if you covered this issue in the last part of the call, but is there any risk that the Retail bonds may be disqualified? Thank you.

VICTOR MASSIAH: We had...let me say, I cannot say too much because, obviously, there are some rules to be respected. But Mrs. König has been visiting our country last Monday and I have no reason to even mention the hypothesis of Retail bonds being disqualified. Regarding the liquidity coverage ratio, I have no problem to say that the last figure we had is the area of 140.

ALBERTO CORDARA: Okay, thank you very much.

OPERATOR: The next question is from Delphine Lee with JP Morgan. Please go ahead.

DELPHINE LEE: Yes, thanks for taking my questions. First of all, just wanted to ask on TLTRO. Do you anticipate any negative impact on NII from the maturities which are coming in the next 2 years? And if you could just provide a bit of color around what your assumption is. Secondly, just wanted to come back also on your comments around the outlook on your revenues when you mentioned in a press release that you think consensus is already sort of there. I'm just wondering, I mean, could you give a little bit more color on what you think...where do you think the level should be for this year versus last year, particularly NII and fees and commission? Thank you very much.

VICTOR MASSIAH: Regarding the, let's say, the TLTRO and the effect in terms of the cost of funding, if you can go on Page 6, you may see that we have 173bps as a customer spread and the cost of funding of 62bps going down. Let me stress, this 62bps, as it is written, excludes the TLTRO, first statement. Second statement, in terms of maturity; we made a special line of products for TLTRO. So there is no lending activity that has been matched with TLTRO that expires on a time horizon longer than the time of TLTRO. So this whole thing is matched. It's a special TLTRO match. So when the TLTRO expires, the lines of credit do expire too by contract. So we don't have a problem of matching maturity.

Still, you may say, well, how are you going to finance additional lending activity? Again, this is why we are saying we are building up some additional funding. This is why, for example, we had an additional cost of interest, because of increased liquidity deposited at the ECB. For example, we have been having days of €7 billion, €8 billions of overnight deposit at ECB. So there’s a good reason why we say we are not worried at all of TLTRO. But let’s make an even more, let's say, wild statement, I hope there will not be another TLTRO. Did I answer your question, Delphine?

DELPHINE LEE: Yes, thank you, very much. And on my second question around the revenue outlook?

VICTOR MASSIAH: The revenue outlook, yes. We see on the fee part of the story, notwithstanding the markets, some additional growth. On the NII, I cannot make an absolute statement because, again, it will depend on both, market conditions, is the spread the same way it is or is it growing better or worse; and the funding, is the funding market opening or not? And third is the competition pricing back again at a rational level on the lending part of the story. Let me say that if we had a rational environment, where rational environment implies a re-pricing in the rational way of the lending activity, then there is a possibility of having a plus also on the NII. But "this back to rationality" must happen. I'm talking about what is commercial, for one, because I'm not taking in consideration opportunistic and non-opportunistic activity on the proprietary portfolio, I'm talking about the sustainable part of the story.

DELPHINE LEE: Great, thank you very much.

VICTOR MASSIAH: Thank you, Delphine.

OPERATOR: The next question is a follow-up from Ignacio Cerezo with UBS. Please go ahead.

IGNACIO CEREZO: Yes, a quick one. If you can give us your best approximation to trading income in '19. Thank you.

VICTOR MASSIAH: For trading income, let me say it's going to be hopefully a regular year. Why a regular year? Because on one side, we do not expect any special things and we're not going to play poker during such volatility. At the same time, the volatility could help us to do some trading. So even if it comes from a very irregular year, we expect a regular year in terms of contribution to the profit of the bank.

IGNACIO CEREZO: Thank you.

VICTOR MASSIAH: Thank you.

OPERATOR: For any further questions, please press "*" and "1" on your telephone. Mr. Massiah, there are no more questions registered at this time. Excuse me;

there is a follow-up question from Hugo Cruz with KBW. Please go ahead.

HUGO CRUZ: Hi, sorry for abusing your time, but what is a regular year for trading? 130 million?

VICTOR MASSIAH: Excuse me, Hugo, it is very noisy.

HUGO CRUZ: What is a regular year for trading income? What is your number you have in mind?

VICTOR MASSIAH: During previous years, the part that was normalized, was in a range from 60, 70 up to 100 million, depending on the single year. That was more or less the range.

HUGO CRUZ: Thank you very much.

VICTOR MASSIAH: Thank you.

OPERATOR: Mr. Massiah, there are no more questions.

VICTOR MASSIAH: So thank you, everybody, for attending this conference. I wish you a beautiful weekend. Thank you to all of you.