UBI Banca

"Consolidated Results as of 31 December, 2016 Conference Call"

Friday, February 10, 2017, 15:30 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 31 December, 2016 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 the UBI Banca. Please go ahead, sir.

VICTOR MASSIAH: Thank you, madam. Good afternoon to everybody. On Page 3, first of all takeaways from 2016. The results are generally ahead of the first phase of Business Plan expectations.

We have a stable lending activity, absorbing the run-off portfolio decrease and the clean-up of EVA negative positions.

Focus on Asset under Management and Bancassurance has been confirmed, with a significant and continuing growth recorded that has been reflected in the commission income increase.

Ongoing reduction and re-composition of proprietary securities portfolio, strong cost control, and the total costs of the year have been lower than 2015, notwithstanding higher contribution to the Resolution Fund and to the other one (Deposit Guarantee Scheme).

500 people exiting the Group at the end of February. This would be ahead of what was scheduled in the plan.

Overall, we have received 1,250 requests for voluntary exit already in the first part of this year, which means that we have additional room to anticipate cost reduction. Let me remind you that the whole up-front costs of the Business Plan have been posted in year 2016. So this won't mean any additional cost.

Improving credit quality has been confirmed with significantly lower stocks, lower inflows that are comparable to pre-crisis levels and altogether higher coverage. Bank migrations will be completed in February ahead of original planning.
2016 results created altogether the premises to expect a 2017 financial year with strongly improved results.

Let's start on page 4, with the Common Equity Tier 1 ratio fully loaded: this was 11.22% or if you wish 11.70% pro-forma including the absorption of the DTAs (deriving from the shortfall reabsorption), or 11.48% phased in versus a SREP requirements at 7.5% with an advantage of almost 400 basis points. These numbers include the computing of a dividend of €11 cent per share that will be proposed to the General Meeting.

Just a reminder, this is perfectly in line with our plan of 2020, 12.8% fully loaded CET1 expected without the absorption of the 3 bridge banks: if the transaction concerning the bridge banks is completed, we expect an even higher CET1 at 13.5%

In terms of CET1, we have to remember that we have the negative impacts of the Business Plan costs, extraordinary contributions to all the different funds, the Atlante Fund has been impaired at over 45% of the amount disbursed. We have also a negative effect from the AFS portfolio for the widening of the spread. And obviously the dividend for the new shares issued for the repurchase of the minorities that has taken place in November.

On the other side, we have the positive impacts from exactly the minority share repurchase in BPCI and BRE, 28 basis point on CET1 fully loaded and 10 basis point on phased-in. The obvious difference is due to the fact that the impact of minorities was partial on the phased in. Reduction of the EVA negative corporate loan positions obviously was a positive.

Page 5, stable performing loan volumes, significant decrease in NPEs. From an optical point of view, it appears that the net loan book has been significantly decreasing from €84.5 billion to €81.8 billion at the end of December 2016. Actually, in terms of net performing exposure, it's much more flattish.

In particular, if we focus on net performing exposures on customers, excluding the CCG, we have actually a perfectly flattish situation with an increase in the medium-long term and a decrease in the short-term lending. So the real reduction is due to the net non-performing exposure reduction, which has been extremely significant from €9.7 billion to €8.0 billion within one year. I will elaborate on this later.

On direct funding, deposits reflect once again inflows from other banking institutions. Current account and deposit growth has been nearly 10% year-on-year. Current accounts and deposits were at €47.7 billion in December 2015, and are today at the end of December 2016, at €52.4 billion.

Retail bonds have been decreasing 28.6% or €5.8 billion, but actually they didn't go as it could appear to the current accounts, not necessarily there, as there is a comparable increase in the Asset under Management and Bancassurance activity, which has increased by €6 billion year-on-year.

So altogether, a very satisfying situation on the total funding from ordinary customers, that has altogether grown from €121.1 billion to €123.7 billion.

I will leave to your readings the bond maturities in the following years and let's go to the retail bond and the institutional bonds. And as you can see, there is no issue on that, we wanted for transparency to share with you our materials.

I will focus more on the Slide 8. In the Plan, we have declared a significant reduction of the total amount of the securities portfolio and a diversification of the portfolio itself. As you can see, this has been already implemented for a significant slice; we went from 20.2 billion at the end of December 2015 to 17.9 at December 2016.

And in particular, the Italian Govies side of the story, it was 90.6% (of the total financial assets) in the year 2015, and today 73.8%, actually anticipating the pace to approx. 50% where we expect to land in 2020. At the same time, in absolute terms, this portfolio has been reduced by €5 billion. And the maturity of the Italian Govies portfolio: you have the position in available for sale, held for trading, and held to maturity, represented in the bottom part of the table. The duration anyway is 2.7 years.

Page 9, net interest income trends, touching floor as we had already anticipated in September with significant savings on funding costs. Let's see the full year and then we will elaborate on the last quarter. Full year, we have a reduction of 8.2%. Now if we split between the contribution from financial assets and interbank exposure, and the one from business with customers, we see there is a radical difference in terms of percentages.

Very well correlated to the reduction of the Italian Govies portfolio, you will see that there is a radical decrease in the contribution to net interest income by this type of portfolio, with a minus 21.9%, while on the customer part of the story, the reduction is 5.3%. On this, I would like to elaborate more because I think we have done already a good job to position the bank in a situation to benefit in the future.

We had promised, in the Business Plan, that we were going to reduce for more than €200 million the cost of funding. This has already been achieved in the first year: the actual reduction in the interest expenses was 235 million. What was not good was the contribution of the lending part of the activity. The activity in terms on volumes were flat, but unfortunately, the price war has shrunk the mark up to a level that has been higher than the reduction of the cost of funding.

However, in a situation where the price war should cool down, this bank has already been positioned in way to benefit fully just from the increase in the mark-up. In a way we can see some of this happening already in the last quarter. As you can see, the last quarter was substantially flattish, and actually it would have been fully flattish, if we hadn't had to make a transaction with a single customer that was a very good transaction because we recovered the full cost of credit, but we had to give up €2 million of interest income, but apart from this special situation it would have been completely flattish.

The last but not the least part of the story, is that we are still not posting the TLTRO. We have not been posting in the year 2016 any benefits from

TLTRO2. So we have been accumulating this benefit and we probably will see this fully benefiting 2017.

On Page 10, you will see the net commission income that confirmed a positive trend above business plan expectations. The increase has been 2.7% on a yearly basis of which there is a higher contribution from the up-front fees from 11% to 14%. This is due to the fact that the type of products that are being sold are more equity linked than bond linked. Performance fees were a little bit lower, but the volumes placed as you can see are much higher, plus 20%.

On, the other side, in terms of banking related commissions, we see that there has been still a decrease that did not counterbalance the management, trading and advisory service linked commissions increase, but even there we are seeing that in terms of last quarter trend, we see a rebound. The last quarter banking related commissions are €155 million and higher than €150 million in the last quarter of 2015.

As I said before, you can appreciate on Page 11 that the mix between "equity, balanced and flexible" and "bond and others" has been rebalancing. In the last quarter, there has been an additional one full point of redistribution. So as per today, "equity, balance and flexible" are 46% versus 54% of "bonds and other".

On Page 12, we analyze the operating costs. And if we go to the bottom line of this slide, you can see that from a nominal point of view, there has been a decrease of 1%, but actually this includes all the contributions to the Funds. If we exclude the contributions to the Funds, you can see that actually on the core part of the story, the part that we can control, we had real additional reductions of -2.6%, which in my opinion very good, ahead of plan and quite significant considering that we are coming from many, many consecutive years of important cost reductions.

Let's now tackle the credit quality. On Page 13, we see first of all, the further progress in de-risking the performing loan portfolio. You can appreciate that starting from December 2013, we have quite an important increase in the low risk component, 77.5% as at December 2016 with medium risk at 14% and only 4.4% of the portfolio is at high risk; so very high quality.

This is important not just to show off, but it has a real impact on the new inflows from performing to whatever type of non-performing, and this is of huge importance from a strategic point of view.

You can appreciate that year-on-year, I am on Page 14, we have halved the inflows from €2.4 billion to €1.3 billion, minus 46.9%. And from the peak of year 2012, we have decreased the incoming by 70%. Even in the last quarter, we see a minus 33%. So altogether, a radical change in the situation of the inflows; actually a change that is driving us more or less to where we were in year 2007, which means that we are back to levels pre-crisis.

Having much lower levels of inflows, it is much easier to start to decrease the total stock, both on the gross and net situations. Gross non-performing exposures have been decreasing from December 2015 from 13.4 to 12.5, actually reducing from 15.1% to 14.4% of the total gross loan book portfolio. Let's not forget that the total gross loan book portfolio including the non-performing has been reduced. So actually the reduction is even higher. From a net point of view, we had below 10% from 11.5%; we are now at 9.8% (of the total net loan book) with a very important radical reduction from 9.7 billion in the year 2015 to 8 in year 2016.

This obviously helps also the coverage part of the story. In line with new regulations, write-offs were registered in fourth quarter 2016. Total stock of write offs amounts to about 2.3 billion. We have left to your reading in annex 11 the regulators' orientation that is in favor, I repeat, in favor of write-off, we left this reading in annex 11. So considering the write-offs, the coverage is 45.8%, increasing by 8.6 percentage points, if we compare to where we were at 37.20% in the December 2015. We have then a splitting between the different situations, bad loans, unlikely-to-pay and past due.

We wanted to share with you on Page 17, an additional focus on the NPEs. The percentage of guaranteed loans, including collateral and personal guarantees on total loan portfolio, is 75.7% of total loans, but if we focus on NPEs, actually this figure increases significantly. So of all the NPEs, 87.7% do have a type of collateral or guarantees. But you may say collaterals are much more important, we do agree. As a matter of fact, 81.9% of that 87.7% are with, let's say, physical real estate collateral. This is very important because it gives you an idea of how to compare in terms of coverage ratio, including this huge percentages of collateralized.

This is justified also by the fact that, we don't have all the figures for 2016 from the competitors, but still in 2015 we were the best bank in terms of rate of bad loan recovery. We confirm that the figure this year is 4.5%, the recovery rate is taken from Section A.1.7-Part E of the notes to the consolidated financial statements, and consists of the ratio between payments received during the year, and the sum of gross outstanding bad loans at the beginning of the year, plus the gross inflow during the year. So this is measurable and comparable with competitors.

Let me summarize what's going on. The Single Bank project is "work in progress" which is ahead of schedule. The merger of BPCI and Banca Regionale Europea has been taking place on 22nd of November without any particular type of accident, actually it was very smooth. So we decided to anticipate the second wave and the third wave and concentrate them in one single wave that will take place on February the 20th, quite ahead of schedule, the original expectation to complete the Single Bank project was first half of year 2017.

Also anticipating again the schedule, 500 staff will leave within this month, within the 28th of February. In addition to that, we have already received altogether 1,250 applications out of the 1,300 that were for the whole time horizon of the plan. So this means that we have gained the possibility after talking with the unions to anticipate additional exits.

Increasing the NPL coverage also through the use of the shortfall has been done starting from June 2016 and this was also helped by the significant reduction of the new NPE inflows. Almost all costs enabling business plan implementation have been up fronted. In terms of revenues we are perfectly in line with expectation, but with a different mix. We have a lower net interest income - because of the price war on the lending activity - that has been fully compensated by higher net commission and higher results from finance.

Costs: net of the extraordinary contribution to the resolution fund, operating costs are lower than business plan expectations. The Cost of risk is lower than business plan expectations and stocks are lower than business plan expectations. The Net result, net of Atlante fund and extraordinary resolution fund provisioning, is better than business plan expectations. So as per today, it's been a start that allows us to confirm our targets for 2020.

Outlook for ordinary operations, net of non-recurring items for year 2017. As anticipated at the beginning of this presentation, net normalized results for 2017 are expected to grow substantially, facilitated, among other things by the conclusion of the Single Bank project ahead of schedule. The overall trend for operating income is one of growth compared with 2016, as a result of the combined effect of the following main components:

- growth in net interest income, notwithstanding a smaller contribution from the proprietary portfolio, also due to the forecast further reduction in its dimension (of the proprietary portfolio). An improvement in net interest income from customers is expected, benefiting from a recovery in volumes of lending, the further re-composition of direct funding towards less costly items and, last but not least, the positive impact of the expected achievement of volumes of lending targets for TLTR02.
Since we have not still been posting it, this means we do have many 10s of millions to post in the net interest income.
- continued growth in fee and commission income from indirect funding with a greater contribution from the running component.

As we said before, the positive conclusion of the recent trade union agreement and the encouraging result in applications to the Solidarity Fund make it possible to improve the target for the containment of recurring operating expenses.

The particularly low risk attaching to the performing portfolio, the action to increase coverage undertaken in the first half of 2016 and the continuation of the reduction in inflows of new non performing loans and in the stock of NPLs as a consequence, should confirm the substantial reduction in loan losses forecast in the 2017 business plan.

As concerns the operation to acquire the 3 Target Bridge Institutions, the pre-closing conditions are taking place with the expected modalities.

Thank you for your attention. I am ready to take all the 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 Ms. Azzurra Guelfi of Citigroup. Please go ahead, madam.

AZZURRA GUELFI: Hi, good afternoon, Azzurra from Citi. I have a couple of question. One is on the cost of risk. The underlying cost of risk has gone down year-on-year, but we have seen that you have made some decision on increasing the write-offs. So when we look at 2017, should we expect that you would continue to process more write-offs or would you push more for some coverage increase in the area where you think you might need still a little bit in case you need to? The second one is, when I look at your outlook, it feels that you are more optimistic than you have been in the past to me, and the only thing that you haven't mentioned is about asset yield. This is still something that we should expect to remain quite tough, the competition in this environment. But overall, can you share the feeling that the environment seems a little bit better on the revenue front for you at least? And then lastly, if you could, can you give us some highlights of what are the next steps for the three banks deal? Thank you.

VICTOR MASSIAH: Yes. Let's start with the cost of risk. It's not that we have one single strategy, different types of solutions are applicable to different situations. For example, this year, opposite to other years, we were less oriented to strike deals for the sale of NPLs. We have sold only for 160 million mainly in the last part of the year 2016. And this doesn't mean that if somebody comes with an appropriate price we are not selling. On the other side, write-offs are peculiar for certain specific situations, not for everything. But I want just to stress on the write-offs: apparently write-offs were hell until now. And apparently we were almost the only ones to do write offs, and now, as you can see from annex 11, it is exactly the opposite: there are recent recommendations to apply write-offs in certain situations. Altogether, Azzurra my point is very simple. As I said to many of you, in a storm, when there is a rainstorm, you first stop the water from entering the house and then you empty the house. We have done that, we stopped the water from coming in. It's much easier now to empty the house. And we are very optimistic to empty the house. And I think there are very few banks that can show these figures in terms of stock decrease.

On the asset yields, why am I more optimistic? Part of it, because I see that in some areas the price war is relaxing a little bit, secondly let's not forget that we do have this additional ammunition coming from the fact that TLTRO is still not with us. And it is an important thing because the whole TLTRO is 40 basis points that we are not posting and just for you to remember, we have already €10 billion of TLTRO, maybe we will take a little bit more if volumes go in the right direction, and altogether this means that we can post also what we did not post for 2016. So altogether we see an important improvement that more than counterbalances the lower contribution from the proprietary portfolio.

Let's not forget also that we have done quite an important growth in asset under management and for asset under management as you know, the starting point is not the previous year’s average, but the last figure. So you start from the end of December where we have an important, much higher stock than at the beginning of the year. This was a very good year for us on asset management allowing us to be a little bit more optimistic also on different parts of the story.

The other reason to be optimistic is the fact that we have been demonstrating to be quite in control of our costs. And to me, the most important one is, as I said at the beginning, the cost of risk. We already, as you can see the annex, hit one of the lowest in historical series during the crisis for provisioning: on page 30 you see what we have in 2016, if we do not consider for a second the shortfall maneuvering, which is a different story. We have 87 bps, which is pretty good, still not where we want to be, but pretty good compared to the previous years, and which can go lower. So that's why altogether, I'm pretty optimistic.

Regarding the activities of the three banks, as you know, this is exactly the transitional period between the signing and the closing. We have read, all of us, that Atlante had its board approving the acquisition of €2.2 billion of NPEs that will come from these three banks. So it's the detail part of the work taking place, it's not our work, it’s the work of the seller. But just from the news that we do have at the moment, we don't see any particular issues.

We had a debate regarding the real estate consortium, we had different opinions, but we have managed to reach a consensus on a certain figure. At the moment, we have a situation where it's going consistently with the Plan. Obviously, we have still to start and I have to say, we are starting with the authorization process. So we have all the respect for the different authorities that have to approve the deal, but on the other side, we have no reason to expect anything particular to hold back the program. I hope I answered your question, Azzurra, did I forget anything?

AZZURRA GUELFI: No I'm okay. Just wanted a little follow up on the TLTRO, should we expect the benefit (on NII) visible already next quarter?

VICTOR MASSIAH: No, we would like to be as conservative as possible. So no, we don't want to do that next quarter. We'll do probably kind of one-off at the end of the year. It would be a kind of last quarter party.

AZZURRA GUELFI: It will be a little bit different from peers?

VICTOR MASSIAH: Yes, I understand on one side, it could be a little bit misleading but on the other side, we decided to be as conservative as possible. We go till the end, till the period of accumulation and then we post it. Maybe right, maybe wrong, I don't know, but everybody has its own CFO, I have the CFO I deserve, for the good and for the bank.

AZZURRA GUELFI: Okay, thank you, good luck to you.

VICTOR MASSIAH: Thank you, Azzurra.

OPERATOR: The next question is from Giovanni Razzoli of Equita SIM. Please go ahead, sir.

GIOVANNI RAZZOLI: Good afternoon, three questions. The first one a clarification, in Slide #4, you are showing 11.7% CET1 pro forma, including the impact of the DTAs, I guess related to the three Bridge banks. I was wondering whether we shall add to these levels also the….

VICTOR MASSIAH: Excuse me, excuse me, let interrupt you before you elaborate. It has nothing to do with the three banks, the 11.70%.

GIOVANNI RAZZOLI: Okay, so is the DTA that you generated after the increase in the…

VICTOR MASSIAH: Probably I was generating confusion. One thing is 11.22% versus 11.70% which is our own DTAs. The DTAs that we've been generating in year 2016 by the use of the shortfall. The other one (the 3 banks) is another 70 and it's the difference between 12.8% and 13.5% in year 2020. Just to clarify, before you ask us.

GIOVANNI RAZZOLI: Okay, so you are basically clarifying my point, because I was asking what would be the pro forma CET1 including the recognition of the badwill and the capital increase that you are about to launch I guess in the next couple of weeks or so?

VICTOR MASSIAH: Obviously it's not only that, but it explains mostly the difference between 12.8% and 13.5% on the Slide 4. Sorry to interrupt you, but I thought it was better.

GIOVANNI RAZZOLI: Okay, because I was mislead by the DTA, I thought it was the deal of the 3 good banks.

VICTOR MASSIAH: Yes. As concerns the other DTAs, the ones that we already generated ourselves, just to piggyback on your question, we are saying that until 2018 we should use our own DTAs. And then from 2018, to 2020, 2021 whatever it would be, we have no maximum time, we have no limits for the usage in terms of time, we will use the DTAs generated by the new deal.

GIOVANNI RAZZOLI: Okay, thank you for the clarification; that was exactly my point. The second question relates to the trend in the asset quality. I have seen that there has been a quite healthy reduction in the unlikely-to-pay. I was wondering whether, and sorry for the very precise question, whether this trend in the unlikely-to-pay reflects the calculation that you've mentioned that is you had a migration from the unlikely-to-pay into non-performing in the Q4. And then following these migrations, you had €455 million write-offs, which then translated into the decrease in the stock. So that's my second question. The last one that relates to the IFRS9, you are showing that your low-risk portfolio has actually increased - the percentage of your low-risk exposure has increased, this would imply in theory that the impact of the IFRS9 should be relatively low in your case, but on the other side, we know that you have a larger exposure to medium and long term loans which actually would impact of the IFRS9. So if you can share with us what are your initial thoughts about these new accounting principles? Thank you.

VICTOR MASSIAH: First of all, write-offs, have to do just with the bad loans. So they have not impacted the unlikely-to-pay.

GIOVANNI RAZZOLI: Yes. My question was…sorry to interrupt you, my question was did you record a migration of the unlikely-to-pay to NPLs and then you wrote them off or the trend of the unlikely-to-pay reflects a back to bonus (performing loans) trend on a quarter-on-quarter basis?

VICTOR MASSIAH: I hope I understood the question. Let me start from the performing. The reduction in the inflow from performing to unlikely-to-pay, obviously will have the most important impact two-three years from now, why, because the highest costs of risk is always coming from the migration from unlikely-to-pay to bad loans, because this is the big step in terms of additional coverage. When you go from performing to the first year unlikely-to-pay, you probably have let's say 20% of coverage. If you go from unlikely-to-pay to a bad loan, you have a 40%. When are we with unlikely-to-pay migration? Since on average the migration from UTP to bad loans is 2.5 years, three years after, we are paying this year, crossing this year, the peak of the crisis that was in 2013. So it's still high, the migration between from unlikely-to-pay to bad loans, but I expect it to reduce from now on, for the very good reason that in 2014 and 2015, we've already seen some important reduction in new inflows, even if it was not as much as it was this year.

So, I hope I'm answering your question. It’s still a peak from unlikely-to-pay to bad loans and this is true for the whole system for what I see. But from now on, if you go back to our historical series of inflows for 2014 and 2015, from a mathematical point of view, this is not an opinion, it's a mathematical point of view, we must see a reduction of the migration from unlikely-to-pay to bad loans driving with itself a reduction of the cost of risk. Giovanni, did I answer your question?

GIOVANNI RAZZOLI: Yes. Thank you, basically you are saying that going into Q4, the migration was stronger than you expected, and it will slow down in 2017. Thank you.

VICTOR MASSIAH: Yes, exactly. Did I forget any answer to you, I am sorry…

GIOVANNI RAZZOLI: Yes, please. On the IFRS, there is a mix of….

VICTOR MASSIAH: Excuse me, yes. In a way, you made a very good picture of this situation. We do have a much lower risk in our portfolio, implied in our portfolio. It's true. And so, this means that compared with others from a risk point of view, we have a much lower risk. Then of course, there could be higher duration. But altogether, we expect as everybody, some impact, but just a reminder to you, we are still not ready to, let's say, to share the details of the impact, but we made an effort in the Plan to make an estimate. So the figures that we have been publishing, the 12.8% as an example for 2020 does already imply the effect of IFRS9 on our capital ratio, which I am not sure everybody is doing or has done. So, 12.8% implies an estimate of IFRS9; then we can be wrong; we can make some mistakes but be aware that 12.8% includes the effect of IFRS9.

GIOVANNI RAZZOLI: Thank you.

OPERATOR: The next question is from Domenico Santoro at Autonomous. Please go ahead, sir.

DOMENICO SANTORO: Hello, hi, good afternoon. Thanks for the presentation. A couple of questions on my side, I will go one by one maybe. First of all, again on these unlikely-to-pay, I have seen that you've reclassified into non-performing some €250 million in Q2, and another €293 million in Q3, and now there is another migration of €450 million. A curiosity, we know, we already know the ECB documents, there are a lot of you know, qualitative comments, but not quantitative. What's the trigger that basically forced you, or basically suggest you to move these unlikely-to-pay into non-performing. Is that because they're all over one-year, two-years, three-years or there is also a qualitative analysis here?

VICTOR MASSIAH: Of course, it’s a combination of the two, Domenico. But let me say, if you ask me to make a sequence in terms of importance, the concept of the difference between unlikely-to-pay and bad loans is that in the unlikely-to-pay, we think there is a reasonable probability that the customer will remain alive, that we have a possibility to help our customer, to help our client to go back to life. While when the customer is in bad loans, we have given up that possibility and our only effort is to take as much money as we can back from the customer. This is the real life definition of the business between unlikely-to-pay and bad loans.

As a matter of fact, we have been working with a special team not for one year but for many years, in terms of recovery. By the end of last year we have decided to divide this special team, and now we have a special team focused only on unlikely-to-pay and a special team focused only on bad loans. And this is because the mission is different, and the skills are different. The skill of the unlikely-to-pay team is, “let's identify a way to allow our customer to survive”. On the other side, for bad loans, “let's take as much money as we can”, forget the customer. Of course, it's not uncorrelated with time, but you can have some restructuring situation where it's justified to have an unlikely-to-pay of five years, because you have a five year plan with your customer. But when you give up with the concept of helping your customer to survive, then it’s a bad loan. Did I clarify the point, Domenico?

DOMENICO SANTORO: Yes, that's clear. I mean, its €1 billion moved in one year, I understand that it's a matter of analysis quarter-by-quarter, but my simple question is, why were they still there basically? They were still there under unlikely-to-pay that should perhaps have been bad loans.

VICTOR MASSIAH: Because we were making an effort. We were making an effort to help them to survive. It's very simple. Domenico, you can find, at the same time, somebody from the fifth year and somebody from the first year to go to bad loans. It's not written in the stone, it depends on the situation of the customer. You can have, for example, a private residential house customer that has just been restructuring his mortgage plan and is making a huge effort to pay, to come back to pay. On the other side, you may have a single entrepreneur that in one year is going bankrupt. You have all the situations. I always invite all of you not to generalize on the credit risk part of the story here. Simplifying and generalizing this credit risk history is always a bad advice.

DOMENICO SANTORO: What's the migration rate at this point, also because the stock is lower of course on unlikely-to pay and non-performing, which is implied in your cost of risk for next year?

VICTOR MASSIAH: It's…well, it depends on the years, but usually it start with two, usually you can have a 20% to 25% depends on the year, depends on what you have in the stock.

DOMENICO SANTORO: So another €1 billion is likely to move, right, next year.

VICTOR MASSIAH: Honestly, for our economy and our social community, I hope nothing is going to come, but then obviously statistically and potentially, it could be anything between €600 million to €1 billion, it's a possibility, absolutely right.

DOMENICO SANTORO: Right, okay. I read also the comments on the write-offs. I know there was a fiscal reason to do write-offs in the past and…

VICTOR MASSIAH: This was in the past….

DOMENICO SANTORO: Correct. That was the reason why you didn't do in the past, because you are conservative. But now, apart from the regulatory, is there another reason to do that, because going forward with the write-offs, of course your coverage will look cosmetically lower and would expose you, of course, on that, more critics on this side.

VICTOR MASSIAH: If I had to follow every figure, I would have sold my whole NPLs for 20 basis point, and for example, now I would have a certainly heavier reduction done but at a much higher cost. I would have given up about €2 billion for 20 basis point, which is a much higher cost. So I think as a shareholder and shareholders should be grateful to us for having stuck to the current situation.

Anyway, if we want to go to Page 32, which is Annex 11, Page 32, you go on the technicalities on the right part of the slide, third statement, Write-offs can take place before legal actions against the borrower to recover the debt have been concluded in full. A write-off does not involve the bank forfeiting the legal right to recover the debt. What do we mean by here? That here is a paradox, somebody's thinking that write-off is less conservative. Actually, the write-off is saying: from an accounting point of view, I post 100%, but I'm still fighting from the legal point of view. So we have the paradox that you guys read the write-off as less conservative, actually it's more conservative. We can go for years on that, but you guys should start to think different.

DOMENICO SANTORO: So basically, apart from you know, moral suasion from the regulator and of course the situation in place, there is no reason basically to do a write-off today apart from….

VICTOR MASSIAH: Now, I was trying to say exactly the opposite there, Domenico. I was saying that we were doing the write offs much before the moral suasion. And there is a good reason to do that because it's more conservative, it's not less conservative.

DOMENICO SANTORO: Okay, understood. On the NII, its fair, I mean this is quite positive actually that the commercial part is bottoming out, but just to understand because your tone is more positive and this could be very important for the banks, especially I mean in a situation where interest rates might go up maybe in the future. On the interest expenses side, did I get correctly that Q3 there was a reduction in interest expenses?

VICTOR MASSIAH: On the funding part, we reduced €235 million. It's written on…just one second, Domenico, I will find the page…9. On page 9 or Slide 9, you have on the right part of the slide; interest expense is down by €235 million year-on-year thanks to the re-composition of the funding mix, increase in sight deposits and decrease in retail bonds which was exactly what we were promising in our plan.

DOMENICO SANTORO: Exactly. That was my point. In the Plan, you mentioned a number which was €270 million, €280 million. So my question is whether this is almost exhausted now in terms of re-pricing?

VICTOR MASSIAH: No, no, because as we said in the expected outlook for the next year, we are expecting to do additional savings. Actually, we are ahead, because we were promising 270 in Plan in the full time horizon and we have been reaching most of it already in the first year.

DOMENICO SANTORO: And without this €40 million you know the TLTRO2 benefits, your NII for next year would be still up. That's a component you know that makes a difference.

VICTOR MASSIAH: I said from the very beginning that this is a component that helps, that allows us to make a strong statement. Then would I expect anyway it to go up? if I trust the last development in the last quarter, and project it with a lower level of price and a higher level of volume, from a mathematical point of view it must go up.

DOMENICO SANTORO: Okay, understood. Thank you. Thank you very much.

VICTOR MASSIAH: Thank you.

DOMENICO SANTORO: Thanks.

OPERATOR: The next question is from Mr. Hugo Cruz of KBW. Please go ahead, sir.

HUGO CRUZ: Hi, thanks. A few quick questions, if I may. First of all, can you say what the impact of the IFRS9 is in your planned targets, you know, quite a few other banks have given a number? And second question, can you tell us what was the impact of high yield AFS bond spreads in the quarter, and what could be the impact from year end until today from the spread that we are seeing, you know, obviously they are spiking compared to year-end, you know, the impact on core Tier 1 ratio? And third, what would be the timing for the capital raise and for a more detailed business plan that I think you will be publishing? Thank you.

VICTOR MASSIAH: Hugo, as I said, answering another previous question we are not ready to give details on the IFRS9, but as I said the IFRS9 impact estimated by us in the plan is in, is already included in the 12.8% Common Equity Tier 1 ratio planned for 2020. AFS impact, as you've seen before, we have reduced the sensitivity to the AFS spread effect, due to the fact that we have shrunk significantly the amount of Italian Govies. Altogether, if you are asking, if there is an additional impact from the end of the year till now in terms of spread increase, of course there is, that is not so significant. It can be in the area of very low double-digit or high-single digit, it depends on every single day situation.

HUGO CRUZ: Okay, and the timing potentially for the capital rising?

VICTOR MASSIAH: If everything goes right and we are ready to have the closing within the three months that we were planning, obviously consistently with all the authorization that we do not control, this would mean that we would be able to go for the capital increase within the first semester of this year. Obviously, I have to be prudent in my statement, because I have to be authorized. But we would be ready if everything goes smooth to present to our, let's say, standard annual General Meeting the proposal for the capital increase, if everything goes smooth.

HUGO CRUZ: Okay, thank you.

VICTOR MASSIAH: Thank you, Hugo.

OPERATOR: The next question is from Victor Galliano of Barclays. Please go ahead, sir.

VICTOR GALLIANO: Thank you. Yes, a couple of questions from me. Firstly, on Slide 17, when you look at your recoveries, they were 4.5%, so that's very good, I mean compared to the rest of the industry. Where do you think…do you have a medium term target for that, do you think you can do better than that or do you think you are kind of hitting the ceiling here in terms of recovery rates? And also, can you just recap again what you said about you know, what percentage of those with collateral and personal guarantees, what is the kind of real collateral element to that? I think it was 81%, you said in one case, if you can just go through those numbers again on the NPEs in particular? And then lastly, with regard to IFRS9; I know you are not giving any more disclosure here, but you are talking about what's baked into that 12.8% CET1? I am assuming that is just the day one adjustment. Is that correct?

VICTOR MASSIAH: This is correct. This is exactly what it is as the first step. And then, of course, it could have some additional effect year-after-year, but if we do, as we are planning, an appropriate first adoption approach, the continuous effect would be very marginal, if any. In particular if we, as we hope, won't have 20 years of crisis, if we go for…just not saying a positive trend, just a normal trend, the IFRS9 effect should be almost nought, again, if we do an appropriate and professional first adoption approach.

Going back to your previous question; let's go together again on Page 17. I would like to answer first to the guarantee part of the story. Victor, let's go on the left part of the story. On the left part of the slide, you can see that we have 75.7% of our total loans are guaranteed. Then what is the percentage for NPEs, is even much higher, it's 87.7%. So first part of the answer to your question is, we do have almost 90% of our loans that do have some type of guarantees. But this is including, both personal and non-personal guarantees. So we said, let's do an additional focus and thinking those figures, let's go to understand how much we have real estate collateral total guaranteed.

Real estate evaluation obviously must be updated at some date, if not it is not significant. So we are talking about real estate updated evaluation. And we have a percentage of 81.9% of the total guarantees are collateral, real estate. If you want to apply 81.9% to 87.7%, you get a 72%. This 72% is the amount of real estate collateral updated in terms of value on total NPEs which I think is very significant one. And that's why we have a certain type of coverage that actually if added to the coverage itself now stands much higher than 100%.

VICTOR GALLIANO: Okay.

VICTOR MASSIAH: Please, Victor.

VICTOR GALLIANO: Sorry, just a very quick follow-up. Do you provide a little bit more than that, do you provide what percentage of your bad loans, UTPs is guaranteed or should we assume it's relatively similar?

VICTOR MASSIAH: Could you say that again, I didn't understand.

VICTOR GALLIANO: This sort of disclosure but with more granularity, because this is for all your NPEs, right? So just, if you break it down to bad loans and unlikely-to-pay, does it change materially ?

VICTOR MASSIAH: That's what I wanted to say, exactly right. There is not a significant difference in terms of percentages between unlikely-to-pay and bad loans, not significant, not such to come out with different messages.

VICTOR GALLIANO: Okay, great. Thanks very much.

VICTOR MASSIAH: And you asked about the 4.5% on the right part…actually it is good, and actually until last year it was the best in the breed. I don't know this year, because the other banks have not published all the results. But can it improve? I think we do have this percentage for two reasons. One because I am arrogant enough to say, that the quality of our non-performing is higher than others, but this is arrogance; organizationally the fact is that we do have a specialist team since 2009.

Second, we did more, we said that the team is split in two now, and as you have probably followed the debate before, we said that there are two different missions for unlikely-to-pay and for bad loans, and we are saying we specialized in two different teams, a certain type of people for the unlikely-to-pay, another type of people for the bad loans. If helped by an improved economic environment obviously recoveries could be even better, but we can do the organizational effort, we can do the improvement in our systems, but we must also admit that the other part of the story is an improved economical environment. So I'm not ready to promise because we do receive very mixed messages from the economic environment. Yesterday, data on the industrial production was gorgeous, unbelievable in a way. If the industrial production for the whole year is now 1.6%, this is very promising for the projection of the GDP for 2017, it has nothing to do with 0.7% or 0.8%, but we get mixed messages, and so, I will remain conservative for the moment.

VICTOR GALLIANO: Okay, thanks very much.

VICTOR MASSIAH: Thanks to you.

OPERATOR: The next question is from Andrea Vercellone at Exane. Please go ahead, sir.

ANDREA VERCELLONE: Good afternoon, three quick questions from my side. The first one relates to your guidance, in particular to costs. You state that because lots of applications to the Solidarity Fund have been forthcoming, it is now possible to improve the target of cost containment on operating expenses. Can you elaborate a little bit on that, since the Solidarity Fund target in the plan is actually for 1,300 employees, so you are still within the amount you had already included in the Business Plan? And then, second one is just a clarification, a curiosity, once you will have agreed with the regulator, the NPL management plan that you need to provide to them at some point, do you plan to make some disclosure to the markets or not? And the third one is very quick, if you can give us some guidance for the tax rate in 2017?

VICTOR MASSIAH: Starting from the 1,300 for the full time horizon of the Plan. We are seeing now that, first of all, the wave of the first 500 exits in the Plan was foreseen to start in the second half of the year. And this has started already in February. So this is anticipating the benefit effect. And if agreed upon with the unions, we can anticipate even more than expected, thanks to the fact that we have already received now, not during the four years of the Plan, 1,250 requests.

ANDREA VERCELLONE: Can you clarify that that will not imply more costs?

VICTOR MASSIAH: Don't forget that we have posted already the full cost, €320 million in June. So that means that we don't have to post any additional costs and we get a lower level of total staff costs in an anticipated time, so this is real full benefit.

ANDREA VERCELLONE: So you land at the same point, but the benefits come before, and if these people leave before you had planned, you don't need to make additional P&L charge in terms of restructuring costs, correct?

VICTOR MASSIAH: That's correct. And we get benefits ahead of schedule. So at the end, as you have perfectly pictured, at the end, it would be exactly the same savings, but we get this savings ahead of schedule, with an obvious benefit to the total profitability of the whole time horizon.

On the NPLs management, I don't know, I really don't know what the Authorities want to do in terms of communication with this Plan. So I really cannot answer. This is not a decision obviously of the single bank. On the tax rate, let me say that we should land in the area of 35%, more or less.

ANDREA VERCELLONE: Okay, thank you very much.

VICTOR MASSIAH: Thank you, Andrea.

OPERATOR: As a reminder, if you wish to register for questions, please press "*" and "1" on your touchtone telephone. Mr. Massiah, the next question is from Riccardo Rovere of Mediobanca. Please go ahead.

RICCARDO ROVERE: Yes. Good afternoon to everybody. Just one question from me. NPEs on Slide 14. In slide 14, you showed that the inflows from performing into NPEs in general as far as I understand it, is basically at the same level of pre-crisis, but the stock of provisions this year, the amount of credit losses this year, and even if I strip out the component related to the shortfall, is more than €700 million, so it is about 90 basis points. On top of that, you say that the cost of risk next year is expected to be significantly lower. How can these get so much lower when the inflows are already at pre-crisis levels? And in connection to that, what was driving in 2016 more than €700 million credit losses, which with such low inflows, as shown in Slide 14?

VICTOR MASSIAH: Riccardo, as we all know, most of the cost is dependent on the total stock and in particular, on the migration from unlikely-to-pay to bad loans. The unlikely-to-pay is still quite high. And this is exactly why we have had such an amount of cost this year. But as I was saying before, what is going to drive the future will be the total stock, which has been significantly reducing, and what will be the new stock of unlikely-to-pay and again, this is going to be reducing for the very simple reason that the new inflow is much lower. So as a driver, I would see the combination for the immediate of the stock and for the future of the inflows.

We are saying that the cost of risk would be significantly reduced this year (2017), because we are saying that the peak of the migration of unlikely-to-pay has been touched this year and on top of that, the new inflows anyway do have a contribution, and they are much lower than the previous year.

RICCARDO ROVERE: So it is a bet on a lower migration of unlikely-to-pay into the sufferenze (bad loans)?

VICTOR MASSIAH: Well, it's not only a bet, because the stock is lower, so in theory and in practice probably, the migration is going to be lower. And again, the other component is the new inflow and we have expectations that the new inflow would be even lower than this quarter.

RICCARDO ROVERE: Okay, thanks.

VICTOR MASSIAH: Thank you.

OPERATOR: Mr. Massiah, sir, there are no questions registered.

VICTOR MASSIAH: Okay. So, madam, let me thank everybody for attending this session and I wish a good weekend to everybody. Thank you.