Investor & analyst call – Edited transcript

6M 2022

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Company participants

- Fernando Mata Verdejo, MAPFRE SA, Chief Financial Officer
- Felipe Navarro López de Chicheri, MAPFRE SA, Head of Capital Markets & Investor Relations and Treasurer

Presentation

Felipe Navarro López de Chicheri

Good morning, everyone and welcome to Mapfre's Results Presentation for the Second Quarter 2022. This is Felipe Navarro, Head of Investor Relations and Capital Markets and Corporate Treasurer. It is a pleasure to have here with us our Group CFO, Fernando Mata, who as usual will walk us through the main trends of the quarter. At the end of the presentation, we will open up the Q&A session. We invite you to send us your questions using the Ask a Question link at the bottom of your screen. We will try to answer all of them as time allows. And the IR team will be available to answer any pending questions after the call. As a reminder, the replay of this webcast will be available shortly after the call.

And now, I would like to turn the conference over to Fernando. Fernando?

Fernando Mata Verdejo

Thank you, Felipe. Good morning, everyone. Before going into the details, I would like to start with a few introductory remarks. Despite an extremely challenging start to the year, MAPFRE has closed the first half with satisfactory results, supported by a very diversified business profile and a strong financial position. We continue to implement our current strategic plan, and targets remain valid.

Some initiatives had been delayed or adapted to the current context. The combined ratio target could be more challenging, but as of today there is no evidence of not being able to reach profitability and dividend targets. Growth on a like-for-like basis has been excellent in core markets – Spain, Brazil and reinsurance, as well as across LATAM – and currency movements have boosted these figures.

We maintain a disciplined approach and are growing in profitable lines such as General P&C and Life Protection. We're focused on organic growth, and our M&A strategy, as always, is extremely prudent. The market environment isn't easy, as difficulties from the geopolitical situation surrounding the invasion of Ukraine persist, continuing to aggravate already growing inflation, rising interest rates and weakening the global growth outlook.

Nevertheless, profitability has been robust, reaching a net result of nearly EUR338 million with an ROE of over 9%. We're benefiting from a high level of diversification, with very different trends across business lines. Profit contribution was strong from core operations and direct exposure to the Ukraine conflict is negligible. Better technical results in General P&C and Life Protection are helping mitigate ongoing pressure in Motor and Health, with a solid contribution from financial income in many markets.

Furthermore, we are seeing the benefits of the restructuring processes implemented in recent years, which are reaching the final stages in many countries. The continuous streamlining of the assistance business is coming to an end with the recent disposals in Turkey and the Middle East, and these efforts are reflected in Asistancia's positive contribution to results this year. Finally, the complete exit from Indonesia and Philippines for both direct operations and Asistancia is imminent, pending only local authorizations.

I would like to spend some time commenting on the Motor business. This segment is currently experiencing several headwinds, and it is extremely exposed to inflation and higher mobility. There are also other trends that are putting pressure on claims costs: changes in driving patterns, spare parts inflation, and supply chain disruptions which are leading to longer repair times.

We have quickly defined and executed profitability initiatives across all regions, focusing on three main drivers. First, tariff increases on both new business and renewals; second, cost contention, both internal and external claims costs. We are actively managing the spare parts and trying to speed up repair times thanks to our preferred garage network and tow trucks. And third, even stricter underwriting measures and selling business in specific portfolio segments. These measures will take time to affect the bottom line, especially in the case of tariff increases, and it could take several quarters to converge to a sustainable Motor combined ratio.

Finally, MAPFRE continues to boast a very strong solvency position and high level of financial flexibility. The Solvency II ratio was 205% as of March 2022 and the Tier 3 bond that we issued in April should boost its position by over 10 percentage points mitigating the fall in shareholders' equity. We are very well positioned to weather the current environment, even with the high volatility in financial markets. We maintain high levels of liquidity and a prudent approach to investments, with modest credit risk, while lowering the duration of our portfolios.

Now I will comment on some of the figures from the first half of the year. Premiums are up 7.3% in euros. If we eliminated the impacts from currency movements, which added 4.9 points to growth, a large multi-year policy issued in Mexico last year, which took away 4.5 points from growth, and the exit of Bankia VIDA which took away 0.8 points, premiums would have been up 7.7% with strong trends in Non-Life.

Regarding the positive currency trends, the most relevant were the U.S. dollar, up around 11%, and the Brazilian real, up over 18%. There were high single-digit and even double-digit appreciations in other Latin American currencies. The combined ratio was 98.3% with a 5 point increase in the loss ratio, driven by the pressure in Motor, and also reflects the drought that took place in Brazil and Paraguay. The two point reduction in the expense ratio is noteworthy, reaching an excellent level of 27%. This is supported by very strict cost control in all areas.

The pressure on combined ratio was partially mitigated by the improvement in financial income, which was up EUR54 million on the period in Non-Life. The attributable result reached nearly EUR338 million with an ROE of 9.2%, 8.4% excluding the impacts of Bankia and other extraordinary charges booked at the end of 2021. Shareholders' equity is down around 10% on the period, 4.6% on the quarter, at over EUR7.6 billion, mainly due to the reduction of unrealized capital gains due to the rise in interest rates, which was partially offset by currency appreciation.

We have also disclosed on this slide the main extraordinary items. The non-operating impacts include the restructuring of Assistance business operations. And regarding operating impacts, there was negative development of the Parana River drought claim reported during the first quarter, which is now an EUR88 million net loss for the Group. EUR51 million of this is at the reinsurance unit, and the remaining EUR37 million is at insurance units. By country, EUR28 million corresponds to Brazil and EUR9 million to Paraguay.

Financial gains and losses are slightly up on the year, but still at modest levels. We expect a higher level of gains for the second half, mainly from real estate transactions – a building in Bilbao and the JV with Munich RE that should be formalized by year-end. The line “Other” for 2022 includes an impact in Spain due to the tax relief for realized gains and dividends for certain qualifying equity investments, and the tax credit that it was recognized in Peru after the merger of the Life and Non-Life units. Full disclosure of the different components of these items is included in the annex at the end of this presentation.

During the first half of the year, insurance operations contributed over EUR10.5 billion in premiums and over EUR320 million in results. I would like to highlight again the resilient performance in Iberia – premiums are slightly down, mainly due to the exit of the Bankia business, with Non-Life premiums up over 3%, with a strong performance in General P&C and Health. The combined ratio is up 1 point to 97% due to the pressure in Motor with a ratio of 100%. The net result was over EUR180 million with positive trends in other Non-Life segments, helping mitigate the pressure in Motor. Portugal boasts excellent Motor and Non-Life combined ratios together with spectacular premium growth figures.

In Brazil, premiums were significantly up with healthy growth trends in Agro, Motor, and Life Protection. The attributable result was over EUR44 million, up over 20%. The strong improvement in Life Protection and high financial income have mitigated pressure in Motor, as well as the impact from the drought. The overall combined ratio was at an excellent 94%, with very strong trends in General P&C in the second quarter, including the Agro segment and also a slight improvement in Motor. Currency appreciations has also been a positive driver.

Premiums in LATAM North were up 28% when adjusting for the multi-year policy, and LATAM South grew 26% in euros. Local currency growth was solid in most segments and it's worth mentioning Mexico, up 20% excluding the multi-year policy, Peru, up over 20%, Dominican Republic up 15% and Chile up 36%.

Overall, in both regions, the strong improvements in Life Protection profitability was offset by the pressure in Motor. The combined ratio in LATAM North is at a good 96.5%, while in LATAM South there is more pressure from inflation and the combined ratio reached 103.5%. Net results were up in both regions and in LATAM South extraordinary tax impacts in Peru offset the impact from the drought in Paraguay.

Premiums in North America were up nearly 24%, of which 10 points were contributed by the Century business transferred from ASISTENCIA at the end of 2021. Performance continues to be affected by rigid tariff regulation, growing mobility trends and increased severity. The 3% Motor tariff increase at the beginning of the year is complemented by the 3.2% increase that was recently approved and is being implemented in July. On the other hand, there is excellent performance in Homeowners.

In Eurasia, premiums are down due to the non-renewal of an important dealership distributor in Italy. In this country, the staff restructuring plan is underway, but savings will take some time to come through P&L. Performance in Germany and Malta has been good in both countries and in line with expectations. In Turkey, the currency is still a drag on both business volumes and results. And the inflationary environment has also been a challenge. The Group has decided not to consider Turkey as a hyperinflationary economy as of June, due to the negligible effects of the restatement of the accounts and other considerations. We will continue to closely monitor the development of inflation during the second half of the year.

At MAPFRE RE, premium growth is supported by positive pricing trends and U.S. dollar appreciation. The combined ratio is 96.4%, which was strong considering the impact from the Parana drought in the second quarter, with a net result of nearly EUR71 million. In ASISTENCIA, the streamlining effort is evident with volumes down almost 58%. The sales of operations during the year had a net impact of EUR8 million on the results; excluding these the unit would have been at breakeven.

I would like to comment in more detail on what we're seeing in the Motor segment. There is pressure in Motor across all regions with a few exceptions, particularly in Puerto Rico, Peru and also Portugal. Anyway, on this slide, I will focus only on our main markets. We have acted quickly to execute a Motor profitability plan across all regions. As you can see on the slide, the fleet is basically stable in the period, only up by a little over 100,000 units, and our growth appetite will depend on the profitability outlook for this segment in the future.

In Iberia, rate increases for new business were implemented in the fourth quarter of 2021, while increases on renewals are being gradually implemented throughout the year to converge with current inflation. Average premiums are now relatively stable during 2022 after several years of declines. We're still seeing a reduction in coverages and other underwriting measures are implemented to maintain the churn ratio stable.

On the expense side we continue with a very strict cost contention for both internal and external claims costs, including spare parts and provider network agreements. We are increasing the number of preferred garages and redirecting clients as much as possible to our network.

In Brazil, there have been multiple tariff increases, but more will be needed obviously to catch up with growing inflation. On the underwriting side, we have also been canceling non-performing brokers focused on higher risk portfolios, such as commercial trucks and buses, with vehicles insured in these segments down over 20% year-on-year.

In the U.S., we were very quick to increase tariffs, ahead of most of our peers in Massachusetts, and already put through two 3% increases during 2022, with an additional rate hike planned for the second half of the year, subject to authorization from the regulator. We also implemented measures on the cost side, increasing adjusters on payroll and redirecting more clients to preferred repair shops. We are applying stricter underwriting policies and further aligning commissions to portfolio performance. These measures will help bring the Motor combined ratio down to sustainable levels, although it will still take some time, while maintaining the fleet stable and best-in-class service levels for our clients.

On this slide I would like to comment on the Life business at insurance units. In Iberia, premiums were down 12%; growth ex-Bankia was down 3%. The Life result has significantly improved, more than doubling, with a general improvement in LATAM supported by lower COVID impact. On the right, you can see that the total COVID impact in LATAM in the quarter was just EUR5 million, only half of the impact we saw during the first quarter. We should expect a better outlook in the region going forward.

Assets under management have decreased 8% as a result of market movements, both due to the uncertain geopolitical context as well as to rate increases in most markets. Spanish sovereign debt continues to be the largest exposure in our portfolio, with nearly EUR10 billion, followed by Italian debt, with EUR2.6 billion. Please remember that a large share of these positions is allocated to immunized portfolios.

During the first half, Spanish govies are up 186 basis points, while Italian bonds are up over 200 basis points, and US T-notes are also up 150 basis points. Equity markets are also down due to tension from the Ukraine war. Finally, regarding third-party assets under management, both pension and mutual funds are down, mainly due to market movements.

On the top of the slide are the details of our euro-area actively managed fixed-income portfolios, which have a market value of around EUR11 billion. The largest move this year was related to the investment of nearly EUR350 million in inflation-linked bonds in Iberia and MAPFRE RE.

As a consequence, we observed a reduction in the accounting yield, due to the features of those investments. And for this reason we present figures carving out this part of our portfolio. Obviously these positions have outperformed plain vanilla bonds during the period. As you can see, excluding these bonds, the accounting yield is slightly up, with duration down by two years in Iberia. As a reminder, the long duration in Iberia Non-Life is due to the Burial portfolio and excluding this the duration would be around 3.6 years.

The portfolio in LATAM also includes approximately EUR1.7 billion of fixed income securities linked to inflation, or floaters linked to Central Bank rates, which represent a little over 40% of fixed income portfolio in the region.

On the bottom, you can see the details of the fixed-income portfolios in other markets, with duration slightly down and portfolio yields up in all markets and regions. This trend should continue in coming quarters as long as Central Banks put more emphasis on taming inflation threats. And as we mentioned before, we have already seen an over EUR50 million increase in Non-Life financial income year on year.

Shareholders equity stood at EUR7.6 billion, which represents a 10% decrease during the period. Net unrealized gains on the available for sale portfolio were down EUR1.3 billion mainly due to the increase in interest rates in the euro area and the United States.

The largest impact was in Iberia, down EUR736 million, followed by MAPFRE RE with a EUR215 million fall, and in North America, net unrealized gains were EUR209 million lower. Currency conversion differences on the other hand are up over EUR400 million on the back a notable appreciation of the U.S. dollar as well as the Brazilian real.

On the right, you have the usual breakdown of currency conversion differences, annual movements and also a sensitivity analysis.

On the chart on the left, you can see the breakdown of the capital structure, which is slightly down during the period, amounting to EUR11.9 billion, which is mainly equity. Leverage is 24.6% with debt levels stable and within our risk appetite. The increase in the ratio is transitory, mainly due to lower shareholders' equity, resulting from the interest rate environment. In fact, the reduction in debt during this period is a EUR167 million. The company has an excess of liquidity as a result of the termination of the agreement with Bankia last year and the issuance of Tier 3 subordinated debt in April this year. This excess liquidity will be used to cover the Group's operating needs and could be deployed where necessary. On the right you can see the Solvency II ratio of over 205% as of March, stable compared to December 2021 and the Tier 3 debt will further boost the position by around 10 points.

To sum up, MAPFRE has reported satisfactory results. Geographical and business diversification continues to be key to compensate negative trends in the Motor and Health lines. Despite a very challenging market context, growth is robust and profitability has been resilient in core operations. MAPFRE RE continues to contribute to results despite a large NatCat impact during the first half of the year, and should continue to benefit from an improving pricing environment. LATAM premium volumes are noteworthy, growing in local currency with positive trends, and profitability is boosted by lower COVID losses and higher interest rates.

Regarding the Motor segment, there is a profitability plan in place across all geographies and these measures should help the combined ratio converge to more sustainable levels, especially in Iberia, Brazil and the USA.

Despite the complex and uncertain environment, MAPFRE continues to implement its three year strategic plan. This is the road map the company needs to be able to move forward in terms of growth and profitability. It is flexible enough to allow each initiative to be adapted to the changing environment when necessary.

Regarding financial objectives, both the aspirational targets and the general framework are still valid. The combined ratio of 94% to 95% will be challenging in the current context, and could be subject to revision in coming quarters depending on inflation. On the other hand, there are several other tailwinds that will help meeting the 9% to 10% ROE target, such as our very strong premium growth and improving financial result, and the positive currency impact.

Excellent solvency and capital levels will also support the 50% minimum payout target and consequently we see at the moment no evidence of any potential risks that could affect the sustainable dividend.

Finally, transformation and ESG targets remain fully valid. Corporate social responsibility is deeply rooted in MAPFRE's DNA and our social commitment is always fully reaffirmed.

Thank you very much for your attention and now I will hand the floor over to Felipe to the begin the Q&A session.

Q&A

Felipe Navarro López de Chicheri

Thanks, Fernando. As I'm sure you're already familiar with the Q&A session process, just let me very quickly remind you that you can use the Q&A tool on the bottom of your screen to send your questions, and we will try to clarify all your doubts as time allows.

Now, let's start with the first question. Michele Ballatore from KBW is asking, "How do you see the cash remittances to the holding this year? I'm more interested in the divisions outside Spain?"

All cash remittances coming from the subsidiaries outside Spain are on track and on budget, and there is nothing that is considered as not normal for the moment. We are considering these as very regular. Fernando?

Fernando Mata Verdejo

Thank you, Felipe. As you may imagine, there is a lot of cash, particularly in Spain. Your question is focused on outside of Spain, but we are reporting a Solvency II ratio well above 500% in MAPFRE Life. So, in any case there is a wonderful cushion in MAPFRE VIDA just to cover any particular needs that we can face in other emerging countries.

Felipe Navarro López de Chicheri

Okay, thank you. This question is coming from Max Mishyn from JB Capital. "What kind of impact do you expect from the fires in Southern Europe?"

Fernando Mata Verdejo

Well, so far we only have one exposure in Spain; we do not have any exposure in Italy, nor in Germany. And from the reinsurance side, so far there is no news, so this is good news. In Spain, as you know, there are wildfires across the country. We do not cover agricultural business nor forestry business, because they are usually covered by Agro Seguro, which is a Spanish pool. But there is exposure in areas adjacent to some areas exposed to fire. So far, there are around 70 exposures that have been affected, though the amount is not that important, and so far we treating these particular claims as a recurring damage claim for Spain.

Felipe Navarro López de Chicheri

Thank you very much, Fernando. Now we have a group of questions related with Motor business. First, we have Carlos Peixoto from Caixa, asking about Spanish Motor business. "How do you see the tariffs and combined ratio evolving in coming quarters?"

Fernando Mata Verdejo

Thank you, Carlos. We are not experiencing the best moment for Motor Insurance, particularly in Spain. This is a difficult situation and mostly due to a combination of inflation and also lower tariffs that were implemented during the pandemic in 2020 and 2021. I guess it's an industry-wide problem, but probably MAPFRE, since the rebates and discounts were higher than our peers, we have to face a different problem or let's say a higher tension in our Motor business.

But in any case, we are applying continuous efforts to mitigate this situation of inflation in claims costs and the Auto plan that has been implemented should flatten loss ratios in the medium run. Also, as we mentioned in the past, in the direct network, what we call the last minute discounts to protect the portfolio, which is our main target, are being replaced by reductions in covers that over time will obviously reduce the loss ratio as well.

Meanwhile, strong cost control is bearing fruit. You see the 2% reduction in the expense ratio compared to last year. And also we renewed agreements with our provider network and also the collective bargaining agreements with our payroll as well with increases below general inflation, which will help us to reduce the expense ratio.

Until all these measures are fruitful, we will count on other income sources that will help compensate the situation in the medium term, particularly financial income, as we mentioned in this presentation and also in the press presentation. There is a significant increase across regions in our net financial income, particularly for Non-Life – there is like a EUR50 million increase compared to last year, which represents an approximately 20% increase. Also our yields are increasing and we are even more optimistic for the second part of the year since reinvestment will be at higher rates as well. So that's basically Spain – it's a tough moment, we have implemented a plan in order to return to profitability, but it will take some quarters.

Felipe Navarro López de Chicheri

Thank you very much, Fernando, for such as thorough answer. Andrew Sinclair from Bank of America wants to know when we expect to see peak combined ratio in America before it starts improving again?

Fernando Mata Verdejo

This is a very difficult question. Andrew, we are happier with the second of the two rate increases already implemented during this year. We will file with the regulator for an additional rate increase in the second half of the year. The amount has not been defined yet, but we'll try to catch up with inflation. When we compare with peers, we have a lower severity change, but in general the frequency is pretty similar.

So let's say that we are facing a tough moment, particularly in the U.S. where the rate increases are regulated, and are working, meanwhile, on the reduction of cost and expenses, we are trying to redirect repairs to our network. Currently between 40% and 45% of car repairs are directed to our network and we should reach a minimum of 75%.

We're also implementing changes with internal adjusters, in order to reduce expenses and be more efficient as well. Ultimately, it will take some quarters, and we are focused on cost and tariff increases, but it's not that automatic like in Europe or other countries. I would say that we have to wait until 2023 to have a better outlook.

Felipe Navarro López de Chicheri

Alessia Magni from Barclays wants to know when the combined ratio in Iberia will improve. That was the main question from Andrew, and you made a thorough analysis on all the countries.

Fernando Mata Verdejo

Our combined ratio in Iberia, I don't think it's that bad, particularly since we had tailwinds for General P&C which stands at 94%, which is a fantastic combined ratio. On other hand, Auto in particular is 100%. And so, as I said, the 94% to 95% target for the entire Group combined ratio is a little bit challenging. The total for MAPFRE Iberia is below 98%, and we should see in coming quarters – and coming quarters doesn't mean in two quarters – probably in four, five quarters, we have to aim for a reduction in combined ratio to achieve around 96%, between 96% and 97%. This will be a more sustainable level in the medium term. But in the long run the combined ratio should be lower than 96%, which was, by the way, the combined ratio that we stood at pre-pandemic.

Felipe Navarro López de Chicheri

Excellent answer. Thank you very much, Fernando. Paz Ojeda from Banco Sabadell is concerned about the competition in Spain, and she wants to know how confident we are on our capacity to increase tariffs in Motor, bearing in mind the strong competition and the lower purchasing power in households due to inflation.

Fernando Mata Verdejo

You're right Paz, but we have to separate the current Auto market in Spain. Particularly for MAPFRE, we have to protect and to preserve our portfolio. We have 6 million cars, and so we have to be extremely prudent in increases, particularly in renewals, so we are applying slight increases month by month in order to keep the number of units stable.

Other peers are focused on tariffs. The main marketing tool for them in order to protect the fleet is to get new business. Their focus on new business is not MAPFRE's situation. We increase dramatically –you can see it on the price aggregators – our new business tariffs. We do not have any appetite to grow while seeing these combined ratios and we will wait to increase our exposure in Motor until we see a better outlook for this business.

So, there are two different peers – there are those focused on pricing, and they have to have marketing tools in the market in order to keep the flow of new business in their accounts. Otherwise, they will lose part of the business. MAPFRE has to focus on renewals of our portfolio. This is our core business and we have to protect it from our peers. That's basically the strategy that we mentioned in the past and that we will focus on the coming quarters.

Felipe Navarro López de Chicheri

Okay. Just as a clarification, I think that Andrew Sinclair was asking when the peak of the combined ratio was going to happen in Iberia, more than in America, I think that you already answered that too.

Fernando Mata Verdejo

In Iberia, that's difficult. We have seen in the last two months, June and May – correct me if I'm wrong, Felipe – but they were more promising. We have a sort of flattening, particularly severity. But we'll see. I don't mean this particular quarter; we have to wait and see how the outlook looks during the second part of the year, frankly.

Felipe Navarro López de Chicheri

Thank you very much. Max Mishyn from JB Capital is asking about the driving patterns. "Do you see any change in mobility trends from the higher gas prices?"

Fernando Mata Verdejo

Not yet. My first instinct would be that people are driving less, but what we are seeing, particularly in Spain, because the U.S. has completely different driving patterns, but in Spain, we are driving more during the weekends, for longer distances as well. Perhaps we are using more public transportation on working days, particularly in cities, but so far, people in general we're coming out of a really difficult period, which was the pandemic and also the lockdown in our homes. And in my view people are driving and this trend will stay quite stable at least during the summer.

Felipe Navarro López de Chicheri

It's quite surprising, yes, but it's happening. Thank you very much, Fernando. Max is also asking if there are any headwinds for Solvency in the second half 2022?

Fernando Mata Verdejo

No, we haven't seen any specific headwinds for Solvency II, just the opposite, in fact. We should publish our figures for the Solvency in the middle of August.

Felipe Navarro López de Chicheri

Yes, in mid-August. So, we will have more information there. Alessia Magni from Barclays is asking about Brazil, "What are the main drivers for the positive development on the first half 2022?"

Fernando Mata Verdejo

Well, there were rate increases across the board, and also a reduction of some loss making portfolios, as I mentioned, in buses and trucks. In Motor there was reduction in the combined ratio. It was promising as well in June. But the main driver for the increase in profitability in the country was a significant reduction in the combined ratio for the Agro business in the second quarter, and also a better performance of General P&C as well.

Felipe Navarro López de Chicheri

Okay. Thank you very much. Carlos Peixoto from Caixa, is asking now about the Brazilian Motor combined ratio, that he says improved in a very substantial way on the second quarter versus first quarter 2022. I think that it was a slight 1% improvement. He wants to know what drove it, and what are the expectations for the Motor combined ratio evolution in Brazil in the second half of 2022.

Fernando Mata Verdejo

The current combined ratio stands at 120 – this is not sustainable, for sure. And we should see reductions in this combined ratio in the second half of the year based on the reduction of units and also the increases in tariffs. Those are basically the main drivers for an improvement in the combined ratio. But what we mentioned in the past is that the long-run run rate for the combined ratio for Brazil should be 100%. It will take, as I mentioned, several quarters.

Felipe Navarro López de Chicheri

Thank you very much, Fernando. Elvis Anoma from Credit Suisse is interested in the Homeowners business. He is asking about the Homeowners combined ratio. Can you please give some color on how it's developing and how you expect it to evolve after this first half?

Fernando Mata Verdejo

Yes, that is a very good question, Elvis. Let's say that 2022 is just the opposite of what happened during the pandemic years, 2020 and 2021, in which there was an increase in frequency, particularly in home repairs. We were locked up and probably we repaired everything we had in our homes and condominiums. What we've seen in 2022 is an automatic increase of rates based on the increase in values, which is something automatic across all geographies, and also a reduction in frequency. The combined ratio is currently lower than 90%; we know that this is not sustainable. It should converge into the low 90s, but it will take some quarters as well.

Felipe Navarro López de Chicheri

There is a question coming from Paz Ojeda from Bank Sabadell about the rocketing energy prices that are already causing business interruption in some plants of industrial companies. She's asking if this business interruption for lack of energy is covered by insurance policies.

Fernando Mata Verdejo

I don't think so, but I'm not sure about this. Let me look into this question properly and then we will come back to you. My first reaction is no, but let me be 100% sure, just in case this is not 100% the answer for this.

Felipe Navarro López de Chicheri

We will come back to you. Usually there is a need for some kind of material damage in order to have coverage for business interruption; this was the main reason why the COVID claims were not covered.

Michele Ballatore from KBW wants to know what kind of reinvestment rate you see in the medium term, considering the rising yields?

Fernando Mata Verdejo

Well, as I mentioned, we reported a EUR50 million increase in net financial income for the Group for Non-Life business. Very, very positive. This is based on lower duration. We did it at the right time. We lowered exposure on equities as well and also credit risk, and we've been opportunistic; there are around EUR1.7 billion of fixed income securities linked to inflation or Central Bank rates. So our exposure in LATAM is very well protected, and there is a positive interest return since, particularly in LATAM, yields are higher than inflation. That's not what is happening in Spain or in Europe. But what we've done in the past in order to have a quite prudent portfolio is bearing fruit during this first half of the year. In this case, we are pretty optimistic as well for the second half of the year, since reinvestment will be at higher rates, and also we have a very, very prudent portfolio and it's bearing fruit. That's my conclusion.

Felipe Navarro López de Chicheri

Okay. Thank you very much. We have a couple of questions now related with the taxes of the

Group. I'm going to read both of them. Carlos Peixoto from Caxia asks, "Could you provide more color on the EUR17 million positive impact and the exemption regime for gains and qualified share dividends belonging to the financial investment portfolio? Is this a one-off or should this have implications for profits and losses taxed in the future, reducing the effective tax rate?

And Paz Ojeda is asking similar questions related to the tax rate, that was low in the second quarter 2022 standalone. Can you elaborate and give us some guidance on the rest of the year?

Fernando Mata Verdejo

Yes, it is a very difficult and complicated tax issue. Please correct me if I'm wrong, or give me help. Probably you remember, Carlos and Paz, that, due to the sale of the Sareb shares, at that point we looked into the different tax regimes that were applying to this transaction. At that point, we realized that there are some capital gains and losses for some eligible equity investments. The threshold to be eligible was investments over EUR20 million. So there are very, very few entities in Spain with individual positions on equities higher than this amount. So, it is probably unknown just for this reason.

At that point, in February 2022, we looked back at the transactions made for the last five years, and we filed with the tax authority complementary tax returns to correct those capital gains and losses for eligible tax over EUR20 million that were made during the last five years. This is basically the net result for the fiscal Group comprising all the Spanish entities; it doesn't apply to companies abroad. And let's say that 95% should be considered as a one-off transaction and that's why we consider it as an extraordinary. There are very few investments higher than EUR20 million in our current portfolio, because we have rotated a lot of our equity portfolio. But there could be some very, very marginal tax exemptions in the future. The phase out of these tax regimes I guess is in 2025, so probably, we won't see any significant impact in our accounts for additional capital gains or losses with this tax exemption. Would you like to add anything, Felipe?

Felipe Navarro López de Chicheri

No, that was very well explained. So, we will look for this movement until 2025. The next question is coming from Charles Graham from Bloomberg. "Can you talk about the pricing trends, particularly in Motor by region, after the deterioration in the second quarter combined ratios? How much is the issue a rise in claims frequency, or how much evidence is there already of increased claims costs?

Fernando Mata Verdejo

Well, we already discussed most of the regions, but I will give you a wrap up. In Spain, for renewals there have been slight increases on a monthly basis, in order to catch up with inflation; for new business, there has been a significant increase in order to limit our appetite for growth. In Brazil, there have been increases across lines and some loss-making portfolio cancellation, particularly trucks and buses. In USA, tariff hikes are regulated so we have already implemented two 3% increases and there is another pending for the second half of the year.

Regarding frequency, we are practically at the same level as pre-pandemic periods, and severity is close to the CPI by region, I guess. In Spain it is a little bit lower; the CPI in Spain is 8, and our cost inflation is a little bit lower, and the same is true in the U.S. and also Brazil.

Felipe Navarro López de Chicheri

So, we could consider that the CPI is bringing some figures for inflation that are not what we consider our internal inflation to be. Thank you very much, Fernando.

We have another question coming from Max Mishyn from JB Capital. "Do you think the tough Motor market can push more consolidation in Spain? Would you consider inorganic growth?" That's a good question on the M&A side.

Fernando Mata Verdejo

Well, it is an easy one – we do not have any appetite for organic growth nor for inorganic; inorganic is even more difficult. We don't know the technical bases of the current portfolios of other entities, so I don't see any further consolidation of the Auto business, particularly in Spain.

Felipe Navarro López de Chicheri

Okay, thank you very much, Fernando. I think that there are no more questions. So, we should be finishing here. We feel that we have answered all of the questions we have received through the platform throughout the Q&A. If any further clarification is necessary, do not hesitate to contact us later.

We remind you that tomorrow at 11:30 Central European Time we are holding a virtual group meeting with analysts and investors. You should have already received the invitation. If you haven't signed up yet or never received the details, please send an e-mail to the IR team and we'll get the information to you. And please remember that you can contact the Investor Relations team at any time, if you have any doubts about the results released today. Thank you very much for your attention today and happy summer holidays to all of you. Thank you, Fernando.

Fernando Mata Verdejo

Yes, thank you again for your presence. And for those that are taking holidays – well-deserved holidays – I hope you enjoy the most. Thank you.

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