Company Participants

- George Quinn, Group Chief Financial Officer
- Jon Hocking, Head of Investor Relations and Rating Agency Management
- Mario Greco, Group Chief Executive Officer

Other Participants

- Andrew Ritchie, Analyst
- Dominic O'Mahony, Analyst
- Henry Heathfield, Analyst
- James Shuck, Analyst
- Louise Miles, Analyst
- Michael Huttner, Analyst
- Peter Eliot, Analyst
- Thomas Fossard, Analyst
- Vinit Malhotra, Analyst
- William Hardcastle, Analyst
- William Hawkins, Analyst

Presentation

Operator

Ladies and gentlemen, welcome to the Annual Results 2021 Conference Call. I am Alice, the Chorus Call operator. I would like to remind you that all participants will be in listen-only mode, and the conference is being recorded. The presentation will be followed by Q&A session. (Operator Instructions) The conference must not be recorded for publication or broadcast.

At this time, it's my pleasure to hand over to Mr. Jon Hocking, Head of Investor Relations and Rating Agency Management. Please go ahead, sir.

Jon Hocking {BIO 2163183 <GO>}

Thank you. Good morning and good afternoon, everybody. Welcome to Zurich Insurance Group's 2021 full year results call. On the call this afternoon, we have our Group CEO, Mario Greco; and the Group CFO, George Quinn. And before I hand over to Mario for some introductory remarks, just a reminder that we kindly ask you to keep your questions to two per individual in the Q&A session. Mario?

Mario Greco {BIO 1754408 <GO>}

Thank you, Jon; and welcome, everybody. Thanks for being on the call. As we entered Zurich 150th anniversary year, the group is an excellent shape. 2022 is also the final year of our three-year strategic plan. We are track to meet or exceed the targets that we established back in 2019 and I look forward to hopefully seeing you all in November when we will set out our ambitions for the next cycle.

As I said back in November last year, the investor update, we have had to be extremely adaptable with the shape of the results being very different than we expected in 2019, given the impact of the pandemic. I'm very pleased with what we have achieved in 2021. Results were among the best in Zurich history with the highest BOP and the best property and casualty combined ratio since 2007. However, we can continue to improve from here and we believe that the trends in revenue and earnings growth will continue at least into 2023.

Across the retail business, we are benefiting from our work on improving customer engagement, which is evidenced by the strong net new customer numbers we have reported. Robust topline in retail and SME, property and casualty embody the excellent life results.

Commercial insurance is reaping the rewards from its reposition in the recent years. With the continuing strength of the pricing cycle providing an additional tailwind. We're also growing selectively in areas such as middle market, where we are continuing our build-outs.

Farmers is making good progress integrating the MetLife business with a strong topline growth for 2021. And the balance sheet is very strong with the SST ratio at 212% and helped the increase in the dividend to CHF22. The SST ratio is before reflecting the benefit we expect to get later in the year when we complete the disposal of our Italian life and pension back book.

I now hand over to George.

George Quinn {BIO 15159240 <GO>}

Thanks, Mario. I just like to highlight a few additional points regarding the strength of our financial performance. P&C's result in 2021 was very strong with 11% topline growth and a 2% improvement in the underlying combined ratio. As Mario mentioned, the 94.3% combined ratio is the best in 15 years. Growth was robust with both commercial insurance and retail and SME, driving growth and it's not just rate driven but also coming from disciplined new business wins. Despite PYD being slightly higher than our guidance range, we believe that reserve strength has further improved and consistent with our prior comments on anticyclical reserving. We've taken a cautious view and not fully recognized the continuing benefit of rate versus loss cost trend.

2022 should be a further year of growth and margin expansion for the P&C segment and we expect to see a further strong improvement in performance in 2022 with the pace only slightly slower than we saw last year.

We're really happy with the life result in 2021, which benefited from the recovery in markets, strong growth momentum in EMEA and Zurich Santander, as well as favorable claims experience. We aim to grow earnings in 2022 at a mid single-digit percentage from the reported growth level. Our continued focus on protection and capital-light savings is serving as well as is our strong presence in the bank channel.

In Farmers, the integration with the acquired MetLife business continues to go very well. The Farmers Exchanges' GWP was up 20% including Met and 7% like-for-like. As for 2022, we expect further growth in the high single-digit range.

The balance sheet is strong and the changes that we're making to capital allocation will improve this further, both in quantity and quality. As outlined at the investor update in November, first is the elimination of earnings dilution. This is not a small number as some of you have already started to estimate. The Italian transaction doesn't trigger any significant earnings dilution and the changes that will likely to come later this year. So hopefully this explains some of the timing. On the use of capital more generally, our preference is to reinvest any further surplus earnings and dividend growth, but if this is not possible we will not retain surplus funds that we cannot redeploy resultedly.

With that, I'll hand over to the operator for the Q&A.

Questions And Answers

Operator

We will now begin the question-and-answer session. (Operator Instructions) Our first question comes from the line of Andrew Ritchie with Autonomous. Please go ahead.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi there. Not often I'm number one on the question queue. Okay. George, could you give us just an update on the reduction of the inwards cash exposure? I remember the Investor Day, I think you talked about 10% AEL, average expected loss, reduction in the US. Just where you are on that in terms of progress? Also, I guess, has there been thinking, because obviously you've reinstated reinsurance since then given more constrained reinsurance was available, do you think the 10% reduction in inwards AEL is enough, or do you think you need to revisit that? So that's the first question. Second question is simple one, why are you realized gains are so high in the second half? I meant -- I thought to mention of equity gains. I don't know, if that was tactical or what else was going on? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Thanks, Andrew. So, I mean, just a reminder that when we had the investor update in November, I talked about what we were planning to do, in fact just started to do already around some of the exposures that the US business in particular brings us. We're aiming to achieve about a 10% reduction in the AEL. That affects a number of different risk types, includes US winds, includes US tornado, includes California quake. If I look at the overall program, we've got about somewhere in the mid-300s in terms of accounts impacted. We're expecting to see about 60% of the benefit by the end of this year, remainder to come next year. And if I look at the progress we're making, we're on track for that. I mean, we're driving it. Again, I gave a fairly high level summary of what we're trying to do to achieve this, but for example on the wind exposed topics we've introduced new creatings and we've got new underwriting requirements to try and direct the capacity more towards the preferred risk. And if I -- for some classifications, we don't offer capacity anymore. So I think we expect to see about 60% this year and 40% next and we're well on track to deliver that.

On the related reinsurance topic -- sorry.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Yeah. No, sorry, still you are about to address that. Yeah.

A - George Quinn {BIO 15159240 <GO>}

Yeah. You have to trust me to remember the second part of the first part of your question. On the reinsurance topic, I'd honestly don't see these things as connected. I mean, I think, as you've seen from some of the US reports already, it's pretty clear the cat aggregate market is a bit dislocated. I mean, we've taken the decision to keep our foot in the door and to see how it further develops, but I mean reality is that -- I mean even though cat aggregate has certainly been helpful for us in the course of last couple of years, it doesn't make an enormous difference.

But if you look at the impact of the change that we've made, so we will retain about another $100 million of exposure and that's before Yellow [ph] as a fact, that we do actually pay for it, as a premium that you would know. So I don't think the change there is significant enough to have us change direction on how we're trying to manage the topic more broadly. So we'll continue to do the things we talked about in November.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Can I just ask --

A - George Quinn {BIO 15159240 <GO>}

Yeah, sure. Go ahead.

Q - Andrew Ritchie {BIO 18731996 <GO>}

On the AEL, obviously this takes time for that reduced AEL to be in place. Is there any earlier benefit from terms and conditions on property exposed or cat exposed property? I'm talking -- I mean, more immediate benefit on things like deductibles or routes [ph] closes your coverage. So long term across that will -- that will affect the '22 underwriting year?

A - George Quinn {BIO 15159240 <GO>}

So if you look at the market generally, this is true beyond property. I mean, it's not just price, I mean you are seeing contractual improvements across the boards. So I mean these range from some of the things that do help define the extent of catastrophe from a property perspective include things like cyber, there's a wide range of things that I think benefit us. I mean we don't try and adopt a number and to all of these, I mean even simple things like deductible. So, I mean, it's a pretty common feature of our response of corporate to higher price to retain more of the risk. So that takes us more of the frequency and provides, I mean, a bit less exposure to those lower events and typically they are not (inaudible). So it tends to help us more, let's say, the attritional and what we would describe as the large, so they can't -- the large manmade events. On the cat side, things like -- that was closely certainly will help. It's a topic across the entire book and if I shall think it's a benefit that you'll continue to see in performance, not through just this year and next, but I think long after we've stopped discussing what the rate trajectory is like. We will still have benefits from Ts and Cs.

Realized gains, so why so high? I mean, so we've made some tactical shifts in the portfolio towards the end of last year. I mean, we don't try and constrain, we don't try and push necessarily for particular outcomes, but the team, they haven't changed the strategic view of risk, but they did reduce equity exposure towards the end of last year and that's one of the driver of the gains. Probably the other principal one is that we have property on a mark-to-market basis and of course given current trends that's generally been positive for the group. Those are the key drivers of what's on gains.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thank you.

Operator

The next question comes from the line of Louise Miles with Morgan Stanley. Please go ahead.

Q - Louise Miles {BIO 20765435 <GO>}

Hi. Thanks for taking my questions. My first one, George, you just mentioned in your intro, you talked about deploying excess capital. Just so that I can get a better understanding, in the release, you talked about net earned premiums in the P&C business growing at mid to high single digits next year or this year rather, how does that translate into capital consumption on an SST point basis, because we can understand that a little bit.

And then my second question is on Slide 4, you talk about the EPS CAGR of 7.3% in the business. If you look at the DPS CAGR, that looks like it's about 5%. Do you plan to close the gap between the two of them? Just trying to have a think about dividend trajectory from here? Thanks.

A - George Quinn {BIO 15159240 <GO>}

And, sorry, on the second part of the question, you were comparing the EPS to DTS, is that what you were doing?

Q - Louise Miles {BIO 20765435 <GO>}

Sorry, the EPS CAGR versus the DPS CAGR...

A - George Quinn {BIO 15159240 <GO>}

Yeah. Okay.

Q - Louise Miles {BIO 20765435 <GO>}

...7.3% on Slide 4

A - George Quinn {BIO 15159240 <GO>}

Yeah. So the -- I mean the easy one to answer is the second one, because that's a foreign currency topic. So you've got -- I mean from -- if you look at the dividend per share and the underlying currency of earnings, it will follow what we've seen underneath. I mean, do we at this point believe we have a gap? I mean, I think I would argue, given we're paying the dividend, this was francs, you've actually got a higher growth rate on the dividend than you do on the earnings at the moment. So I'm not sure from our perspective, there is a gap to close.

And on excess capital, I mean, it's a great question. I mean one of the interesting challenges of certainly the more economic models is that, assuming that we grow the book in a balanced way and in particular if we don't over emphasize some of the P risks and, of course, and the question that Andrew asked, you can see that we've clearly got a restricted appetite for some kinds of risks at the moment. They are more capital intensive. I mean the growth rates that we're guiding to today or 2022 don't consume significant amounts of capital. I mean it's highly diversifying across the portfolio and large -- and if you look at our book and you look at our capital models, it's the traditional P risk drivers that dictate consumption and very few of them are present in the growth plans that we have for P&C for 2022. So I don't expect our organic growth ambitions to be a significant considering our capital.

Q - Louise Miles {BIO 20765435 <GO>}

Great. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thank you.

Operator

The next question comes from the line of Peter Eliot with Kepler Cheuvreux. Please go ahead.

Q - Peter Eliot {BIO 7556214 <GO>}

Thank you very much really. And my first question -- actually, sorry, very similar to Andrew's actually. But if I -- I mean hopefully we won't, but if we did get another year like we did last year and are you able to tell us roughly what the nat cat might be? So I don't say 6.5% last year, just wondering what that was sort of translate to 2023 if we got a similar year bearing in mind that the changes that you've just talked about 200 [ph]?

And the second question, obviously very impressive reduction in expense ratio, we saw that already in the half year. I mean, I think, you said that could be split, previously we said that could split into discipline and also the sort of economies of scale that come with the topline growth. You gave everything and sort of any more feel for how those to drive do space out? And whether we can expect sort of continuation of that if we do get the further growth coming through that you pointed out specifically? Thank you very much.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Thanks, Peter. So if you look at the aggregate cover and we are low for the change, so it's -- and we'll say for the sake of our NIM [ph], because obviously I don't want to disclose the premium. But let's assume that the impact is a $100 million. If everything was the same using the capacity and the aggregate as a gauge, it would be about three-tenths of a point higher. That would be the change.

From an expense efficiency perspective, I mean, I think it's become a hallmark of the group, but it's something that we're very focused on. We certainly hurray that we got the benefit not only of what we've done more efficient and a bit leaner across the entire group, but we've also had the benefit of growth. I think as we go into this year and you look at the expense ratio and we break it into the two components, so we have the acquisition cost ratio and we have what we refer to as the OUE or the administrative overhead component, the Zurich expense parts of the expense ratio

On the acquisition side of it, I mean given the mix of business that we've currently got and the expectations of continuing recovery of the pandemic. I think we'll see some rebound around travel. I think we'll also see some rebound around the mass consumer business, particularly in Latin America. They tend to be relatively high distribution cost businesses. So they probably will not jump the acquisition cost ratio slightly. I don't expect it to be particularly dramatic, but like-for-like we would make it slightly higher.

On the expense side, I mean, we continue to push on expenses. Let me build this trajectory change from where we've been in prior years. I don't think so, I think the -- if I look at all of the dynamics around expense and of course keeping in mind that about 60% of the group's expense burden is salaries, I mean there is a certain pressure from inflationary drivers of expenses. I think, so far, we've been able to manage that by offsetting that with efficiency gain, that's still the plan IFRS in 2022. But what it does mean is that, I mean, probably a larger part of the expense gain will go back to staff, because of the prevailing labor market conditions. So I would expect that volume will be a bigger driver of an improvement overall in the expense ratio in 2022 than perhaps it was in the last couple of years.

Q - Peter Eliot {BIO 7556214 <GO>}

That's great. Thank you very much, George.

Operator

The next question comes from the line of Will Hardcastle from UBS. Please go ahead.

Q - William Hardcastle {BIO 16346311 <GO>}

Well, afternoon, everyone. First one, just I guess with lots of moving parts, COVID catastrophe losses, what's the extent of the favorable year-on-year development in '21? And how does this compare to the pace of change in '20 and without pinning you to any sort of targets, I guess from a high level directionally in pace, any color that you can give on that?

And then the second one is really big high level one, but you've had a huge upgrade it seems on your Life BOP today. I guess a little bit more color here on what's driving it would be useful? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Thanks, Will. So on the first topic and I think if you're prepared to look through the headline numbers and we characterize it in the same way that we have in prior years, I mean, we think that underlying is somewhere around the 92 mark, it would be about 2, maybe 2 to 3 point improvements over the prior year. If you look at 2020 over 2019, on the same basis, it's probably 1, 1.5 points of improvement. I think given the cycle, I would expect us to be closer to the improvement we saw in 2020 than 2021 just given the -- if I did rates moderated as we enter 2022 compared to 2021. I mean, it will also worth adding that the rate that we're currently seeing is 2023 relevant as much as 2022. So to the extent that we continue this through the first half of the year, we will start to firm up precisely what's going to be delivered in 2023 already.

And from a life business perspective, I mean life team -- our life business has globally done a fantastic job. If you look at it from volumes perspective, as a proportion you rate much more of the preferred risks, the growth -- I mean it's not quite back to the level of 2019 on a APE basis, but the mix of what the team's achieving is far better. So we write much less of any of the business that carry spread risk. I mean just a far more of the protection focus, the unit linked focus driven by, I mean, a wide range of businesses on Europe, the Zurich businesses, and UK, Germany, Switzerland, all doing a great job.

Joint venture in Spain with Sabadell, very strong joint venture; in Latin America with Santander also excellent. I think -- I mean one of the ones that -- there's been a big driver in terms of turnaround is the Australian life business. So as we get to the end of 2021, believe it or not, we now starting to get very close to the business case that we committed to nearly four or five years ago when we announced the acquisition. And I think the Australian business has more room to develop further. I think they're quite cautious on how they position themselves at the end of last year with a leading player in retail in the market. I expect to see further strength from them this year.

And the other thing that stands out in the results today, I mean, we've highlighted what we described as one-offs and I think one-offs not a very elegant way to describe some of the hard work that some of the local team is doing managing the enforced results and changes, for example, in particular reserving positions.

I mean, it's not always something that can be predicted with high-precision, but we do have a good track record of producing a reasonably consistent level of income from what we do in-force management. I mean, looking at what's ahead of us, I don't really expect that to change in 2022.

Finally, we have COVIDs. It's the one place in the business where you continue to see the impacts of the pandemic. Tends to have more of a North American and South American flavor to it. I mean we've had slightly over $300 million of excess mortality than the course of 2021. It would be zero this year, but it's going to be a significant step down from where we were last year. So I think if you look at the book overall, I mean we're very happy with the progress the team has made and that's why we've given clean guidance from the headline number without adjustment today

Q - William Hardcastle {BIO 16346311 <GO>}

Great. Thanks.

Operator

The next question comes from the line of William Hawkins with KBW. Please go ahead.

Q - William Hawkins {BIO 1822411 <GO>}

Hello. Thank you very much. And, George, just picking up on the useful color you just gave about the life business, I'm wondering if I could just press you more on some of the line items that are driving this? In the absence of your source of earnings disclosure, your profit is up about $400 million year-on-year in absolute terms, how much of that has come from what would have been the investment margin and how is particular margin, what would have been changed? And when you're thinking about the $100 million growth, 3% or 5% or mid-single digits in place for this year, which would be the key driver there? Is it investment margin or technical margin or maybe something else?

And if I can append to that, I appreciate you've dropped the source of earnings disclosure because of the other pressures like IFRS 17 work, to what extent is there any restatement of your earnings going on behind the scenes, so that you're creating a number which is strategically more consistent with what IFRS 17 may look like? I don't know if I'm taking a conspiracy theory too far.

Second question, please. (Multiple Speakers)

A - George Quinn {BIO 15159240 <GO>}

Well, I'm not sure I understand the second, the question, what does that mean?

Q - William Hawkins {BIO 1822411 <GO>}

Presumably your earnings could be restated significantly under IFRS 17 and so I'm just wondering if whether your new earnings figure includes any kind of implicit smoothening into the new accounting regime. So is 1.8 a good base for what we're going to be thinking about under IFRS 17?

A - George Quinn {BIO 15159240 <GO>}

Okay, great. Thank you.

Q - William Hawkins {BIO 1822411 <GO>}

And then second question, in your guidance of high single digit growth for Farmers' premiums this year, how should we be thinking about the actual operating profit of the management services company? I'm not sure -- I mean on the one hand I can imagine it will be higher than that, because you've got all the lovely synergies from Met P&C and, on the other hand, it could be lower than that, because you still got the integration expenses and things. So do we take the volume as also the sign of profit or if not, which way is the delta please? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Yeah, great. So on the first one, so you're right. I mean we've removed some of the earnings we would normally give because we have eight closes during the course of this year. I think if you look at the sources of the improvement over the prior year and just given the change in the mix of business, I mean, a very significant driver of this is going to be technical margin, it's coming from business that typically carrying underwriting risk. So if I think -- I mean I think to Australia earlier, because Australia has one of the biggest tunnel rooms compared to the prior year. I mean that's a business that's almost entirely combination of either what Australians would refer to as lumpsum TPV mortalities had cover or DI, both of which obviously dominated by protection features and therefore technical margin. So there will be some of this, which is partly a recovery of markets, but I expect the largest driver of the outcome as the improvement in mix towards technical and that technical is driven by underwriting outcomes rather than investment outcomes.

On the second part of the question, on the -- I guess it's a different way of asking me what will your life earnings look like under IFRS 17? All I can tell you is that we haven't done anything from a book perspective to try and anticipate IFRS 17 at this stage and I don't expect that we will do that during the course of the year. I mean the one thing that we did do and we talked about this already on the Q3 call is we did make some changes and bite to the AFR. So law is to say up the best estimates in a way for transition for IFRS 17, so that some of the businesses that potentially could carry more risk into the new accounting standard without more significant buffers around them. But that's really the only thing we've done around anticipating IFRS 17 as I stated.

For Farmers, I mean I think for the management company, I mean they're obviously -- there are full component, so I'm going to put the life company to one side a second, I'm going to put Farmers Re to one side assuming that that has no significant impact. So we're left with, I guess, what -- was the management company now has the addition of MetLife to it? I think the growth figure that we've given for underlying is a pretty good guide to where you'd expect the fee income to go and I think you need to allow the fact we still have some restructuring to do. So that will continue to keep pressure on the margin on the Farmers what place component, which is the old MetLife P&C business. But I think if you work off of the overall guidance that we've given for the exchange and you are prepared to make a reasonable split between the, let's call it, the old management company and Barclay Services and apply the two margins with a bit of a step-up on what place -- I mean that will give you a pretty good guide to where to expect fee income to come out overall.

Q - William Hawkins {BIO 1822411 <GO>}

That's very helpful, George. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thank you.

Operator

The next question comes from the line of Michael Huttner with Berenberg. Please go ahead.

Q - Michael Huttner {BIO 1556863 <GO>}

Fantastic. Thank you so much, and well done on the record profits in a record year. And two questions. The cash conversion -- so it's really a way to ask what's the cash remittance growth going to be, but if I do the ratio of cash to net profit, 85% with five-year average of 95%. So if I imagine convergence, that is a lot of growth to come, just wondered if you could maybe share some of the drivers of what could be? And then the second question. So Italy done -- we have a deal, which I mentioned, in Germany as we -- end of this year. So we'll have a lot less volatility in your -- on your assets side with lot less risk, how much do you believe in terms of CapEx or if you imagine that you could live with lower solvency buffers? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Michael. So on the first one, on cash conversion, so the numbers are correct. We are through the first two years of the strategic plan that we have. Ending this year, first two years, we are very much high guidance of 45% and if you look back on a longer-term historical average, we have been higher than that. I mean we have said today that obviously the ambition is to meet or exceed all the targets that we've given. I think I should remind -- I mean I see no reason why it would slow down as we go into 2022. There's obviously some continuing impact from COVID, although it's not so significant as it was in the prior year and we continue to have pockets that we would like to go after. So we've talked before about the fact that one of our largest entities continues to run a capital level that's in excess of the level that we target and even though we've been successful in repatriating that -- some of that in prior years, it continues to exhibit that characteristic and we would intend to go and tackle that again this year. But I think I mean the reality of those processes are that, I mean, we need to have local boards comfortable, we need to have to convince regulators that these things make sense. So I don't expect a shift from where that business is to perfect line with target on one year. So I think there could be benefits from this that will flow this year, maybe also next year. So I think from a cash remittance perspective, I'm going to obviously avoid giving you firm number, but I'm very comfortable that we'll be in excess of the tax remittance target that we established.

So on the second thing, so obviously we've announced the transaction in Italy, that will have a small positive impact on the SST ratio when it closes as a smaller impact on a liquidity. But I mean the real reason for us to do that again was the volatility that the predominant investment and that book may created issues for us around volatility of capital. I mean, it's a challenge to take too much beyond that, because it goes -- I'm not going to talk about other transactions that we are not considering. I think -- I mean, we've made a commitment that we want to go further in addressing the back book challenges that we have in the company. I think people can draw conclusions quite easily about what that might mean. I mean there is a certain complexity when we move until the jurisdictions again to some degree reflects also the comments around the cash topic.

So we need to work with business team, our local partners and very importantly the regulators to make sure that all the stakeholders are comfortable with what we intend to do here.

I think the positive thing around some things that we do intend to do is that, I mean, they are not dependent on a flow back of local capital. We've been able to put in place relatively efficient financing structures already, really the benefit of doing some of these things is for us to remove some of the superimposed capital requirements or, as you highlighted, to have a lot less volatility and therefore to be comfortable operating at level of capital this lower than the one that we would typically target today. That doesn't mean a reduction in the 160% just means where we operate and the range above 160%.

In terms of quantum, I'm going to resist the temptation to make any comment on that yet, but obviously the things that we intend to do are far more significant than the things that we have done.

Q - Michael Huttner {BIO 1556863 <GO>}

Fantastic. That's sure helpful. Thanks so much, and good luck.

Operator

The next question comes from the line of James Shuck with Citi. Please go ahead.

Q - James Shuck {BIO 3680082 <GO>}

Hi. Good morning, good afternoon. And in terms of the underlying improvement in the combined ratio at full year and when you think about the accident year number ex-COVID, there was a slowdown from the first half to the second half, I think kind of 3 points or so and then 190 basis points or so. I mean to some extent, I mean how should we could expect that and I think you've probably got high loss picks on some of your liability lines, but when I kind of break it out into expense and loss ratio, it seems like the biggest slowdowns on the expense ratio side, so just some color around whether that timing differences or how to think about that slowdown? And kind of linked to that, is -- could you split it out the other way and look at it in commercial lines versus retail and SME, SME I think was increasing by about 80 basis points at the first half and that was flat for the year. So it looks like the retail SME deteriorated in the second half of the year. I guess that's kind of one thing about possible headwind for you as we go into 2022. So just some thoughts about the retail and SME outlook would be helpful please?

And then secondly on the PYD, so I mean -- you have done recently first half of this year, second half of the PYD these kind of at or above the top end of your target range. You are saying that you are building margin at least in this period, so just should we be expecting that number to be coming out at the higher end as it has done in recent times? And if you are able to comment on IFRS 17, when it comes to P&C reserving situation. You'd like it have to reserve closer to best estimate under IFRS 17? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thanks, James. That's a long couple of questions. So in -- on the underlying combined ratio, I mean -- so your analytics is spot on. The one of the things I would chose off to cure as off is the fact that we have a significant expense queuing to the second half of the year. It seems to be one of those things we can manage to bring down the total amount we spend, but we don't really seem to be able to fix the skew so much. I think in the scheme of things, I'm more concerned that we'd become more efficient in total. So I'd love to tell you that we could get this thing more even, but there is a skew into the second half and this partly driving the characteristic that you see.

And on retail SME, again, you're right about the outcome. I'd be more optimistic than you are. I think on retail and SME, it's been a great tough market, especially for retail. I mean, we've seen a rebound in the business and mainly driven by partnerships. So that's certainly helped us. But if you look at the price dynamics, they are pretty flat in retail. I think just given the prevailing market conditions in some of the challenges that are out there, I think in some markets you have started to see an improving trends on price and I expect that to broaden across all the businesses.

So I mean I think is -- as we get deeper into this year, I'd actually expect retail to produce a stronger performance than they have from a rate perspective than that they done by 2021. That's also true for Farmers and the benefit that we'll get from a fee perspective, from what I think the emerging price dynamic is in the US retail market.

On PYD, so where are we going to be? I would expect us to be at or very close to the top end of the range. As you saw last year, we struggled to keep it within the range. I mean -- and general treasure tends to be -- to release more than to release. We've tried to be appropriately cautious or prudent in what we've done, but I certainly thing that as we go into 2022, the high-end of our target PYD range is a better indicator to the likely outcome than the low end.

When IFRS 17 -- I mean, it's an interesting issue. I mean you're obviously aware that there is a high -- there's a great percentage of best estimate component to the choices that are made. I mean, we have not yet been all through that process with the auditor. And I think it would be our intention to make the argument that a management's best estimate, which will include elements that there may be limited evidence of an historical data should still be incorporated into the IFRS best estimate outcome. So rather than see a very large reduction than the expected outcome, I think we're going to try and make the argument that the -- what might be perceived as margins are actually simply reflecting the fact that the data is never perfect and we get constant reminders of issues that can crop up that had not previously appeared in the data. So I'm hoping we won't see that step change down and that we can maintain a similar philosophy as we move into the IFRS 17 model.

Q - James Shuck {BIO 3680082 <GO>}

It's very helpful. Thank you, George.

Operator

Your next question comes from the line of Vinit Malhotra with Mediobanca. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Good afternoon. Thank you, George. Some of my questions have been addressed, but two I could think of. One is on the PYD that you just indicated were a little bit high end of the range 1% to 2%. What about inflation, social inflation, those topics? I mean we'll then be something that have been considered in this sort of revised guidance if I can use that word, because that's the first question?

Second question is just on the dividend and cash flow. So, of course, I mean I have to say my petitions were met and consensus as well, but the payout ratio of 63%, cash flow much stronger, I mean was the reimplement were not doing a bit more, because you didn't want to ratchet up? I mean the dividend policy is higher of last year as well, so if you could just comment a bit about that would be helpful? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Thanks, Vinit. So on the PYD topic, as we have incorporated perspective on inflation, social inflation, yes, I mean, on the introductory comment, I made -- I mentioned the fact that we haven't fully recognized the benefit of rate versus loss cost trends and that's a bit of a departure from prior years. If you look at what we've done in terms of building reserve strength in the earlier periods, I mean, typically, we would have been releasing workers' comp reserves or something similar, maybe autoliability in some of the European markets and maybe adding to some of the more social inflation exposed lines in the US. I mean, this year, we've actually held back part of again what might be perceived to be margin just to increase the level of prudence and give us more ability to manage that topic if it becomes a magnificent. So I think we've tried to be pre-emptive around it and the PYD guidance considers those risks.

On dividend and payout ratio, I mean it's an interesting challenge. I mean -- I think I mean going back to the first question from Andrew, we clearly have a relatively unusual level of unrealized gain than the result today. So I would never simply take the headline number and base the outcome on that. I mean, arguably, I think you could argue 75% might imply something slightly higher. I think there is a -- I mean the several thoughts and the process that we went through, I mean, we've looked back over the course of the -- I mean, last four or five years and if you look at earnings on average over that period in total we're very close to 75% payout ratio. So in years where perhaps for -- because of major losses, we've seen lower earnings and last year with COVID we saw lower earnings, in other years which has been stronger. It has offset if you low for the passage of time. I think we also said in the investor updates back in November, I mean, we clearly want to make sure that shareholders' benefit and a way that reflects the improvement in earnings, but that for a topic -- as a topic for us, it's going to be something for the end of the cycle, not the middle of it.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Good. Thank you very much, George.

Operator

The next question comes from the line of Thomas Fossard with HSBC. Please go ahead.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yeah. Good afternoon. Two questions on my side. The first one that will be to come back on the reserving strengths currently at Zurich. Will you be able to comment on the level of confidence currently that you have in your reserve compared to where it's been in the past, on an historical level, just better understand if -- here also on a historical basis, you feel very, very safe and well actually you're building some additional prudence level, but maybe not all of it will be required going forward.

And the second question would be related to your debt maturity. Actually you're showing a slide, I think it's on 41, slide pack, where in fact you've got pretty significant amount of maturing debt, senior unsubordinated 2022 to 2024 and I was wondering how much it was potentially putting some constraints on you to return a bit more cash to shareholders or I mean is there anything that you could comment on the desired level of debt ratio you want to keep? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Thanks, Thomas. I mean obviously as I look at the reserves, I don't have reserves for events that I don't expect to happen, otherwise I'd be in trouble quite quickly. I think what we're trying to do is to be consistent -- to be conservative around how we approach it and recognizing this is talk rather than something that I'm scientifically proving. I mean, I think, in all of the last three or four years, even with the level of PYD that we've had from our internal metrics, the percentile, and our reserve range has increased. I think the only time that I've seen a good day recently was Ogden, when of course we used part of the reserve strength to deal with Ogden, all other years has gone up and currently we would be at one of the highest numbers. I can't recall here. If I'd, probably the highest number.

I mean, I doesn't mean to say that we've got a port that we can draw on when we wish, but what it does is that we create more resilience around some of the risks that we all know are out there, whether that's the inflation topic that was discussed earlier, I mean whether that's just any other risk that can come up in the portfolio overall and that includes the social inflation or litigation topic in the US. So there's never any guarantee, but any number is going to be enough. With the numbers we have today is higher than the one we had a year ago and it's higher sales in the one year before that, and I think it just gives us a measure of protection against some of the risks that are out there.

From a financing perspective and the general question is that, could there just any constraints for what we might like to do. Otherwise, I mean, not really, I think the -- if you look at the -- I mean we give this simplified capital structure picture, I mean we are very close to the target levels. And if I actually do some redemptions, which take place the other end in this year, it will actually look at the underleveraged potentially compared to target. I mean, our aim would be to maintain around those kinds of levels going forward. So I don't expect the -- that the financing needs that we have over 2022 and 2023 to create any significant constraints on what we would like to do either to invest in the business more broadly or if it comes to that to increase cash returns to shareholders.

Q - Thomas Fossard {BIO 1941215 <GO>}

Excellent. Thanks, George.

Operator

The next question comes from the line of Dominic O'Mahony with BNP Paribas. Please go ahead.

Q - Dominic O'Mahony

Hi folks. Thank you for taking my questions. Two from me. Just first one on the Farmers' outlook, the high single-digit premium growth. I wonder if you could just give us some color on the breakdown of that, the inorganic type -- the organic and I suppose what I'm really getting at is, any sense of how you see that business progressing on a sort of a normalized basis into the next several years in terms of topline?

A - Mario Greco {BIO 1754408 <GO>}

Dom, the second question is really just -- George I wonder if you could expand on your opening comments on capital management.

Q - Dominic O'Mahony

In terms of the use of surplus capital to support growth, one of the things you said earlier was that your organic growth doesn't really seem to create much strain on capital at all and so I'm sort of wondering if you have surplus capital, it's not going to get matter too much if you wanted to sort of fast and accelerate it organically. Is that the right way to think about it that actually we sense that you have surplus beyond that? Organic isn't going to be the way would you deploy it, what if I misunderstood that? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Thanks, Dominic. So on the Farmers topic, I think the easiest way to think about the split of growth, I mean if you look at the growth -- I mean we've given two numbers for last year, so one was, like-for-like, one is including the net. The net contribution is about 75% of the full year. So I expect to pick up the other 25%, so that would explain a slightly higher than normal guidance around Farmers and I'd expect both books to be growing kind of in that mid single digit territory.

I think the rate dynamic as I mentioned earlier seems to be picking up momentum in the US. It's clear that -- I mean there are issues across the market with frequency and severity, that's going to drive rate filings, I think, pretty much everywhere and also in some of the key markets for the Exchanges. You've seen some people step away and maybe move more to an E&S type structure. And I think, again, of course that has a big impact on capacity and hopefully some influence on the regulators where rate has to be filed for us to get or for the exchange to get the required approvals. So I think mean this should be a pretty decent year I think for both of the businesses. But if you're trying to think of the Met part versus the Farmers Management Company, the major part of the drive will be that 25% pickup because of the additional three months.

On the opening comment I made on capital management, I think your interpretation is pretty much spot on. So it's not zero, but if we grow the firm by 10% and we grow across -- especially across P&C and we don't grow in the highly exposed risk categories, I mean, we're not going to get close to a 10% capital usage type number. And if I -- I think I've said in the past that if you think of the capital generation, I mean we have about 75% of it back. We keep about 25%. That would fund, I mean, pretty high single -- I mean, potentially even low double-digit growth rates across the entire firm.

So the organic -- I just don't see that being the principal way in which we absorbed the capital levels that we currently run with. I think from our perspective, I mean, we would like to deploy if we see things that make sense. I think we've been reasonably successful in doing that over the course of the last five years. I mean things are not quite as active on the buy side is, maybe they have been for sometimes studying from the types of risk that we are interested in. But I wouldn't completely exclude the possibility as we go through the year, we'll see things that we think could actually allow us to accelerate achievement, some of the strategic priorities, grow earnings, which of course grows the dividend, which is the primary goal.

Q - Dominic O'Mahony

That's really helpful. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thank you.

Operator

The next question comes from the line of Henry Heathfield from Morningstar. Please go ahead.

Q - Henry Heathfield {BIO 19760919 <GO>}

Good afternoon, and thank you for taking my questions. Can you hear me, George?

A - George Quinn {BIO 15159240 <GO>}

Yeah. Go ahead, Henry.

Q - Henry Heathfield {BIO 19760919 <GO>}

Great. Thank you. Just a couple of clarifications really. So, well -- and interest in some accounting movements as well. On the acquisition of MetLife and into Farmers, I mean, I know you touched on this answering one of the questions, but I'm just -- could I get a better idea of how this business is now changing these performance management services company, which was really just administration services working on the back of Farmers Exchanges and now it seems the acquisition of MetLife, you're actually moving more into kind of an underwriting business performance. Is that the way we should be kind of -- or I should think about it? So we've got this MetLife business, which now sit side by side with the Farmers Exchanges and the Farmers Management Services, FMS, Administration Management Services with both those elements, if you see what I mean, maybe you could help me onto that. That's my first question.

And then with regard to your insurance contracts, since there has been a bit of kind of compression in the valuation particularly within future like policyholder benefits and then in the policyholder contract deposit, I think on the first one of those, there is the big outflow of about $3.4 billion, which relates to the sale in Italy on Life, I was wondering just help me understand whether that's predominantly driven by client, those occasional guaranteed spread business that you really wanting to move away from that and move more into the unit-linked business or there is something else that I need to think about? That would be really helpful and maybe just any color you might just provide, any more changes in the future going forward on kind of that divestments including that from a traditional part of business if that's the case.

And then secondly within the development of policyholder contract deposits -- sorry, that was on the prior question on referring to page 42 in the financial statements. And then on page 43, within the development of policyholder contract province, there is a decrease of around $2.6 billion within both of these movements, FX at the large part play, but there is a decrease of about $2.6 billion related to other comprehensive income. And is that -- should I just, is that really just movements in investments that relate to the value of the investments to say and the liability, perhaps you could just help me answer that. So that's my three questions. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Henry. So on the last one, can I ask you a favor. Can I have the IR guys call you back on that one because they could only give you a better answer than I would on the call. On the other two, on the MetLife, P&C topic, so apologies if I've left the impression that the Zurich side of the relationship is now engaged and underwriting is note, so it continues to be a management company structure. As you pointed out in the traditional model, we provided service for a fee and it continues to be that on the MetLife P&C following the MetLife P&C acquisition. So Zurich is not -- no underwriting alongside the exchange.

Q - Henry Heathfield {BIO 19760919 <GO>}

Sorry, did you acquired MetLife (inaudible) that confuses us. Did you acquired MetLife -- I mean did you acquired the underwriting part in MetLife?

A - George Quinn {BIO 15159240 <GO>}

The Farmers Exchanges acquired MetLife.

Q - Henry Heathfield {BIO 19760919 <GO>}

Do you paying money for this?

A - George Quinn {BIO 15159240 <GO>}

(inaudible) we do think if this is -- the exchange has bought business and we will benefit from a stream of fee income into the future as a result of the acquisition. The exchange expects to be compensated for giving access to that stream of business because we pay them for that as part of this deal. So the way to think if this is that they acquire the underwriter and we're essentially paying them for a perpetual distribution agreement. Is that makes sense?

Q - Henry Heathfield {BIO 19760919 <GO>}

So you bought MetLife and you are providing the exchanges access to the underwriting of MetLife and you started engaging underwriting on the MetLife acquired businesses is the other way I think

(Multiple Speakers)

A - George Quinn {BIO 15159240 <GO>}

It's almost, but the exchange is on the insurance company, MetLife P&C.

Q - Henry Heathfield {BIO 19760919 <GO>}

Okay, can the exchanges bought MetLife P&C?

A - George Quinn {BIO 15159240 <GO>}

Yes.

Q - Henry Heathfield {BIO 19760919 <GO>}

They did, right, okay. And you have no interest in the exchanges?

A - George Quinn {BIO 15159240 <GO>}

No completely independent.

Q - Henry Heathfield {BIO 19760919 <GO>}

Others than the management fee basically which is -- but there is no -- it really does not hold a monetary interest in the underlying exchanges.

A - George Quinn {BIO 15159240 <GO>}

Correct.

Q - Henry Heathfield {BIO 19760919 <GO>}

Okay. I think I get out of it, but thank you very much for three years.

A - George Quinn {BIO 15159240 <GO>}

I mean if it helps, we can spend more time at the offline and go through in more detail. On your analytics around the dynamics, I mean they are probably small and so the preference protection for unit-linked for the non-guaranteed types of life product. And therefore, I mean, you potentially do see some compression of asset balances over time because of that. I mean you will also see quite low volatility because of market movements, but given the group's preference, risk preferences and life, acquiring assets, setbacks, guaranteed life products, it's just not a priority for us.

Q - Henry Heathfield {BIO 19760919 <GO>}

Traditional (Multiple Speakers). Could I ask, are the discount rate (inaudible) point on policy pricing and they don't take over time, correct?

A - George Quinn {BIO 15159240 <GO>}

So we get into detailed conversation about ALM probably. And basically you're correct, I mean these are really viewed -- if you view them from a portfolio perspective, it's affixed on liability, so you should match them at the point of sale.

Q - Henry Heathfield {BIO 19760919 <GO>}

Thank you very much, George.

A - George Quinn {BIO 15159240 <GO>}
You are very welcome.

Operator

The last question is a follow-up from Mr. Huttner with Berenberg. Please go ahead.

Q - Michael Huttner {BIO 1556863 <GO>}
Thanks so much. This is my quick question and I'm sorry, but if you -- you've got fee on the line, but if you would take some moment, you step into (inaudible) and you think either for the next three-year plan or the three-year plan where you're clearly target to beat everything? Which particular metric do you think is the one where you got more subside (Technical Difficulty)

A - Mario Greco {BIO 1754408 <GO>}
Good try, Michael. Fresh.

A - George Quinn {BIO 15159240 <GO>}
There is obviously a part of me rinse with that, Michael, but the other side of me screaming, I mean, no to answer it. I'm going to thank you for the question, but I have already given your response.

Q - Michael Huttner {BIO 1556863 <GO>}
Thank you.

A - Mario Greco {BIO 1754408 <GO>}
That's a good try.

Q - Michael Huttner {BIO 1556863 <GO>}
We tried. If you do have two seconds, you mentioned potential deals and priorities, et cetera, if you could just remind me or us what are the strategic priorities, where would they would lie?

A - George Quinn {BIO 15159240 <GO>}
Yeah. I mean there is slightly -- the priorities we laid out back at the 2019 Investor Day. I mean, we are -- I mean a lot of the activity internally -- I mean, we got -- Sierra and the team was in the country and did a fantastic job in commercial. We're actually devoting a lot of time and effort to the customer topic. You see it reflected in the customer growth, so just if you see it reflected in the customer satisfaction feedback that we're getting, we've done some very small acquisitions lately that we think will help us improve that over time. I mean it's entirely conceivable that we would do a bit more of that going forward, I mean beyond that, it's pretty opportunistic in the end, Michael, because it becomes -- I mean what's available and what fits with what we've told people we want to do and it's pretty hard to predict on events.

Q - Michael Huttner {BIO 1556863 <GO>}
Thank you.

A - George Quinn {BIO 15159240 <GO>}
Thank you.

Operator

Ladies and gentlemen, that was the last question. I would now like to turn the conference back over to Jon Hocking for closing remarks. Jon?

A - Jon Hocking {BIO 2163183 <GO>}

Thanks. Thank you, everyone, for dialing in. If anyone has got any extra -- any questions and please just reach out to me or one of the other members of the IR team. Thank you very much for your time.

Operator

Ladies and gentlemen, the conference is now over. Thank you for choosing Chorus Call, and thank you participating in the conference. You may now disconnect your lines. Goodbye.