Q2 2016 Earnings Call

Company Participants

- Christian Mumenthaler
- David Cole
- Philippe Brahin

Other Participants

- Andrew J. Ritchie
- Frank Kopfinger
- In-Yong Hwang
- Kamran Hossain
- Olivia Brindle
- Philip Kett
- Sami Taipalus
- Thomas Fossard
- Vikram Gandhi
- Vinit Malhotra
- William Hawkins
- Xinmei Wang

MANAGEMENT DISCUSSION SECTION

Operator

Good morning or good afternoon. Welcome to the Swiss Re's Second Quarter 2016 Results Conference Call. Please note that today's conference call is being recorded.

At this time, I would like to turn the conference over to Christian Mumenthaler, Group CEO. Please go ahead.

Christian Mumenthaler {BIO 6479864 <GO>}

Thank you very much. Good morning or good afternoon, everybody, and welcome to our Q2 results conference call. I'm here with David Cole, our Group CFO; as well as Philippe Brahin, our Head of Investor Relations.

Let me start with a brief overview of the results we published this morning. As you've seen, we reported solid results even though the quarter was impacted by large losses and persisting challenging market conditions. Q2 2016 Group net income was $637 million, bringing us to a total net income of $1.9 billion and an ROE of 10.9% for the first half.

P&C Reinsurance reports an ROE of 9.4% this quarter impacted by series of large losses, such as wildfires in Canada, earthquakes in Japan, and floods in Europe. In the July renewals, we continued reducing capacity to our flow business and growing our portfolio of large and tailored transactions. These transactions are placed with us on a private basis and offered differentiated economics. In this context, we managed to maintain our risk adjusted price quality at 102% year-to-date.

Life & Health Reinsurance maintained its solid performance with an ROE of 10.1%. Corporate Solutions results are impacted by two large 2015 related casualty losses; and the Business Unit reports a negative ROE of 4.2%. Because Corporate Solutions currently mainly operates in the excess layer business, it is exposed to a relatively high degree of volatility.

Life Capital delivers another quarter of strong performance with an ROE of 13.4%, once again benefiting from net realized gains from the derivative portfolio of Guardian. We continue to reduce the exposure of this portfolio to this volatility during the quarter.

Finally, our asset management team produced a strong ROI of 3.7%, despite a low interest rate environment. Overall, our invested asset base increased driven by the Guardian acquisition. All business units have now paid dividends to the Group and the capital position of the Group remains very strong.

With that, I hand over to our Head of Investor Relations, Philippe Brahin, who will introduce the Q&A session.

Philippe Brahin {BIO 19081619 <GO>}

Many thanks, Christian; and good day also to all of you from my side. Just before we turn to the Q&A, I would like to remind you to please restrict yourself to two questions each and re-register for follow-up questions.

So with that operator, could we please take the first question?

Q&A

Operator

Sure. The first question is from Xinmei Wang, Morgan Stanley. Please go ahead.

Q - Xinmei Wang {BIO 17860767 <GO>}

Hi. There are two questions, please. My first question is on the losses in the pricing environment. So given that we've seen quite unusual losses in this quarter, I was wondering how unusual do you think the losses are? And would you say that given these, there is an opportunity now to deploy capital in this market in that?

And then my second question is on the combined ratio guidance for 2016 in P&C Re. So do you think the 99% underlying guidance is still achievable, given the results? And I think Matt also mentioned on the 1Q conference call that we should be expecting more growth in casualty and maybe some more pricing impacts to come through? Thank you.

A - Christian Mumenthaler {BIO 6479864 <GO>}

Okay. I'll take the first one. So, in terms of the nat cat losses, Q2, I think overall the sum was $351 million. The biggest chunk of it comes from Canada. That is higher than expected for Q2, but I have to put it in context, so I think in Q1 we had no nat cat losses. And so, together actually Q1 plus Q2, the overall cat losses are slightly below our expectation.

So taken that into account, I doubt that this in itself will lead to higher prices in the next renewal round. I think what will eventually move prices apart from the potential large loss is a whole series of other factors. Pressure is coming from all different angles, one of which being already the low interest rate environment which hurts people; one could be on the reserving side if reserve releases start to be less abundant.

And then yes, if loss ratios overall just approach the average expected loss and you take some of the other factors, it could get into a situation that even in the absence of a very large loss, prices start to stabilize again and maybe go slightly up. But I'd say, Q2 in itself is really nothing particular in terms of the cat loss.

A - David Cole {BIO 7251632 <GO>}

Let me then come back to the second question; thanks for that. Indeed I recall the discussion with Matt, at the time of our Q1 results. You recall in Q1 we had adjusted combined ratio for P&C Re of little bit below 96% or 95.7%, now with Q2 reporting 101.9%. So for the first half 98.8%, which is just slightly underneath the guidance we've given for the entire year of 99%.

There is nothing at this point that would lead us to conclude that we should adjust that. I think what Matt was talking about is just the inherent uncertainty of these estimates, if you will, given the uncertain exact mix of our business, what happens with pricing over the various subsequent periods. So there's nothing now in our Q2 results or developments off the back of the July renewals that would suggest to us that the 99% guidance is still not the appropriate figure.

Operator

Our next question is from Olivia Brindle, Bank of America Merrill Lynch. Please go ahead.

Q - Olivia Brindle {BIO 17273762 <GO>}

Hi, there. My first two questions. The first one, just thinking about your updates of combined ratio methodology. When you talked about that at 1Q, you mentioned there's $300 million of cat losses which effectively come through as prior-year development the following year. So I was wondering if you could update us on how much of this is in the year-to-date numbers so far to be (6:35) relating to 2015. How do we think about that $300 million?

And then secondly on the reserving position and thinking about your buffers, the longer tail lines of business. I was just trying to quickly look through the triangles that you published and compare them to where we were previously. And so it sort of looks like on your general liability lines you're slightly healthier, but the motor is maybe slightly weaker. Just wondering if that seems like a fair assessment and in particular in light of some of the reserve additions you've made on the motor side year-to-date, how has that sort of restored your buffers to previous levels? And that'd be helpful to hear. Thank you.

A - David Cole {BIO 7251632 <GO>}

Thank you (7:15) I actually start with the second and come back to the first. So thanks for mentioning the reserve book that we also publish, as you know, every year at this time. Couple of general comments. So we haven't changed our reserving philosophy. We continue to be prudently reserved, best estimate across the entire book which we go through the process four times a year.

There always are individual adjustments on various lines across the different geographies, but overall, I would say we've maintained our comfort in terms of where we are within the best estimate range, and we tend to be north of 50, actually generally positioned somewhere between 60 and 80, and that continues to be the case. All these individual lines a little bit above that and lies a little bit below that, but overall I think we continue to feel that we have a very appropriate, prudent level of reserves and nothing has changed now related to developments in Q2 that alters that position.

As to the adjusted combined ratio, actually I'm going to say, Olivia, not a whole lot I'm going to give you on that. We've published our numbers for Q1 and for Q2. We're going to come back of course at least on an annual basis and give you folks some updates on that. But I think sometimes there is a little bit of a move toward an almost overly defined, overly experienced type of granularity and accuracy in some of these things.

So, we're going to keep with the numbers that we've produced. There is nothing that's changed. We still have the overall expected loss budget of $1.5 billion. The recognition that not all of it comes through in the form of actual claims during the course of the year that some part of it will hold over from previous year. So, no update there.

Q - Olivia Brindle {BIO 17273762 <GO>}

If I could just follow-up on the reserving side for motor quickly. Are you comfortable now having made, I guess, three quarters of additions on the U.S. side and that's reflective of the market conditions or should we expect anything further there?

A - David Cole {BIO 7251632 <GO>}

No, absolutely. I mean, of course I don't know what will happen going forward, but based on all the information that we know, the information we received from our cedents, we've gone through our portfolios, we've topped them up as you mentioned earlier this year, second time now in Q2. But we believe that the level of reserving that we have for that business is also they're prudent.

Q - Olivia Brindle {BIO 17273762 <GO>}

Okay. Thank you.

Operator

Our next question is from Kamran Hossain, RBC Capital Markets. Please go ahead.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Afternoon, everyone. I've got two questions; one for Christian. I guess four weeks into the job of CEO, could you just maybe run through what are the biggest concerns I guess that you're looking to address at Swiss Re in the coming years? So kind of what are the things that are on your desk at top priority?

And the second question, I guess, one for David. In terms of the realization of gains, obviously second quarter saw quite a bit of that, again, in Life Capital specifically, will these continue throughout the year or are you pretty much done now? Thanks very much.

A - David Cole {BIO 7251632 <GO>}

Yeah, thanks.

A - Christian Mumenthaler {BIO 6479864 <GO>}

Thanks Kamran, for a tricky question. Very smart way to asking. So anyway, to me there is obviously no big surprises because I've been part of the Executive Committee for 10 years now. So, my life hasn't completely changed in these last four weeks. No, I haven't discovered anything I didn't know before. So, it's very much everything in a continuous mood. What is very clear and obvious is that, we're in a cycle, we enter a period that is more difficult, right, the whole industry enters that and it has started a while ago. And I think all the new CEOs in Europe, in particular in the insurance industry, will face some of that.

One obvious one is the low interest rate environment, which now off this quarter is probably going to stay even low, which particularly impacts Life & Health – primary Life & Health to some of our clients, but also some of us, right, because the investment that is really important. So that must be a concern of every CEO in the insurance industry.

And the other one is the obvious pricing cycle in P&C, which is nothing new as always happens and we certainly keep very calm, but we know it's concerning and it's not pleasant when you're on the way down. So we see some slowing down of that, but it's not yet the bottom it seems. And so, I'm mentally prepared for one or two difficult years before the cycle inevitably turns, because I still believe in cycles. Obviously I see nothing that would prevent cycles to continue in the future.

So I've no big news for you. I think it's pretty simple. We have the assets side and we've the liability side, and on the liability side it's the P&C (12:04) area, which is a high concern. Other than that, I have nothing particular in my mind.

I'm sure we'll hear more in December.

A - David Cole {BIO 7251632 <GO>}

Thanks. Let me pickup the second question. Thanks for that. Let me be very sure. There is no way that we would expect the level of profits that Life Capital has delivered in the first half would be repeated in the second half. As you know, we acquired Guardian. We're in the process and in fact of – by and large than what we wanted to do to bring that portfolio under our governance, positioning it also from a Solvency II, moving a little bit out of the derivatives market more into the cash market. Also looking at the underlying investments and determine either they meet our quality expectations as well.

So we've been transitioning that investment portfolio over the course of the last six months and we've frankly benefited. Sometimes it's good to be lucky, so we frankly benefited from during that period of time, interest rates have been reducing while we were still sitting on that derivatives portfolio. But that is now, as I mentioned, by and large done. There's still maybe a little bit of trimming and managing the portfolio that we would expect to do subsequent to the Part VII transfer, which as you know we anticipate during the course of 2017.

Offsetting the P&L benefit that we've seen, it has had a little bit of a drag on the level of cash generation that we report, as a result of the same lower interest rates driving a higher solvency requirement under Solvency II. We experienced impact of that a little bit more significantly in Q1 than in Q2. Actually, very happy to see that the underlying business is very much performing in line with our expectations. The integration of Guardian is very much going in line with our expectation. And also on that basis, we've reconfirmed our target of $1.4 billion to $1.7 billion of cash coming off of that business during the period 2016-2018.

Q - Kamran Hossain {BIO 17666412 <GO>}

Fantastic. Thanks very much.

A - David Cole {BIO 7251632 <GO>}

Thank you.

Operator

The next question is from William Hawkins, KBW. Please go ahead.

FINAL

Bloomberg Transcript

Q - William Hawkins {BIO 1822411 <GO>}

Hello. Thank you very much. Can you tell us what lessons you're learning from these two losses you've taken in the Corporate Solutions division? And also I understand the fact completely, but on the one hand there seemed to be two completely discrete loss events, but there seems to be a great coincidence in location, size, timing and nature of loss. And so, is there something on the underwriting side that you need to learn from that? Or yeah, I mean what's going on with those losses? And then very brief on a point of detail, did you get your exposure there as the follow up in a syndicate, or were you the leaders of bad exposure (14:47)?

And then secondly, a capital management question. This looks like we're heading towards the first year - about four years when you're going to have a normal P&C results. If that happens, it looks like your P&C Re earnings is going to be at least $1 billion lower than they've been for the past few years, which may imply that the dividend from P&C to the center could be lower than for the past few years, which then makes it look like the buyback coverage into the future carry significantly greater risk. You've never kind of committed medium term on that point, but how concerned should we be about the sustainability of the buyback if you do end up getting a few more normal years of P&C results? Thank you.

A - Christian Mumenthaler {BIO 6479864 <GO>}

So, I can take the first one even though of course this is obviously not yet my specialty, but I'm working a lot to get interest. So as you can imagine, we studied that in quite some detail these two losses. And I think there's really - I can't see any commonality between the two, except that maybe they're in California and they have a tort system there that gives very generous rewards to claimants. But I would say, taking a step back, if you think about the whole strategy of Corporate Solutions, to me it still makes complete sense to have that strategy as we're a risk knowledge company and gives us access to risks wouldn't have otherwise.

I think the philosophy of it is also quite clear that is we write risks to the balance sheet - to the full balance sheet of Swiss Re, so we don't try to optimize, this is a little sub part of the business which means they don't buy tons of re-insurance to isolate themselves from returns. As a result of that, I would expect a higher overall return on average from Corporate Solutions compared to some peers, but also some higher volatility where sometimes they have larger losses.

And the team hasn't changed over the years. And if I look at their track record, I think they definitely completely fulfilled that expectation. So, the general performance has been higher than average in the industry, but this quarter - we don't see our compares yet, but this quarter has been hit by two losses which is disappointing, but has to be expected.

I think another factor is a rule which is that, the book isn't that large yet. So, that adds I guess to the volatility we have to expect from that book of business and that's something that should take care of itself over time. I mean this said, it's clear that in this part of the business, everywhere the margins are going down as they do in P&C Re. And the only right thing to do for the team is to be very careful on their underwriting side, having strong discipline. And I think there is a lot of evidence of that that I could find. In particular, they have stopped growing basically now. 2015, they haven't grown; this year they grew a bit, but that's due to acquisitions. If you take everything out, they are actually quite disciplined. So, I have full trust in that business, and at this stage I don't think we need to change anything drastically just because of these two losses.

Q - William Hawkins {BIO 1822411 <GO>}

So to summarize that, it does sound like you're thinking it's more bad luck than anything you need to address.

A - Christian Mumenthaler {BIO 6479864 <GO>}

Yeah.

Q - William Hawkins {BIO 1822411 <GO>}

Okay.

A - David Cole {BIO 7251632 <GO>}

Well, let me pick up the second question about capital management. The first thing is, just to reiterate that the way that we've expressed this in the past continues to apply today. And I say that really just to underline what we hope will over time really be seen as consistency. There is no commitment indeed to future share buybacks. Even the possibility for 2016 is subject to how our capital position will develop during the course of the year, as well as the opportunities that we would see to invest it back into the business at acceptable returns and that's also in line with what we've said in the past.

There is no doubt that if you just look back over the last several years, absolutely correct, we've I think printed some extraordinary profits off of our P&C Re business. Even the first half of this year, notwithstanding the fact that pricing has been under pressure, given the loss burden so far in the first half, ROE for the business is still a very respectable 13.7%.

But in terms of forward-looking comments, let me just reiterate our approach which is of course to maintain the financial strength, to maintain the regular dividend. We are able to increase the regular dividend whenever we are successful in investing into attractive opportunities in the business, that takes precedence over additional share capital repatriations. But sill when we find ourselves sitting on this excess capital that we don't really believe we'll be able to reasonably deploy within a fairly short period of time then we look to give it back, and that takes place in the first instance of course through the dividend. But then as an additional tool, we have the authorization which needs to be renewed in principle every year, we have the authorization from our shareholders.

So I would caution about penciling in these things, we said that before. There's no difference today than what I've said about that in the past. We'll continue to watch how the business develops, our capital position develops, some opportunities to invest develop. And later in the year, if we come to the conclusion that it looks like we're going to be sitting on this excess capital then we'll come back to the market with some further communication around the buyback.

Q - William Hawkins {BIO 1822411 <GO>}

Thank you, guys.

A - David Cole {BIO 7251632 <GO>}

Yeah.

Operator

The next question is from Andrew Ritchie, Autonomous Research. Please go ahead.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Hi, there. I'm actually just following up on William's question just on capital deployment. The first question, David, year-to-date you've seen very strong growth in the business particularly bespoke – three bespoke transactions. Is that still sort of diversifying growth because obviously it's been in casualty lines such that the economic capital – the incremental economic capital required or SST capital required hasn't been that significant, or are we at the point where it's no longer diversifying because casualties sort of reached 50% of the book? So maybe just comment on the capital intensity of the 18% growth year-to-date?

And second question linked to capital deployment. You're very confident regarding that Guardian is going well, that's now integrated. Are we at a point now where you'd be comfortable looking for further deals in the UK? Is the business ready to do more deals? We obviously saw some press commentary about third-party capital, which I think you commented on in the press. Maybe for Christian, if you just remind us again what your attitude is to third-party capital in Admin Re and (21:24) further deals? Thanks.

A - David Cole {BIO 7251632 <GO>}

So let me pick up the first one, Andrew. Yeah, you're right, up until now the additional casual business that we've been riding has been more diversifying than anything else. That of course will not continue forever, particularly if we continue to on the one hand grow that line of business, while we are taking a little bit of capital off the table and the windstorm property nat cat area.

But so far it actually has been – growth hasn't really overall across the group required a lot of additional capital. Our capital position remained strong. You've seen of course all the dividends come up to the Group, but also on an economic basis. Obviously, we have some volatility in the marketplace, but our capital position allows us I think to carry that volatility quite nicely. So, so far that additional business mix or development hasn't really taken a whole lot of additional capital.

I'll turn now to Christian for the second.

A - Christian Mumenthaler {BIO 6479864 <GO>}

Yes. Yeah. I mean you saw our reaction which was basically that we wouldn't comment on the market rumors. So, not surprisingly. I think this said, we said at the Investor Day last year that we would be exploring options to have other capital in that business. And I think the main reason is that, it's clearly a very interesting business with potentially a lot of growth potential, in particular now in the environment you see, I think from all of our segments that could be actually one where there's a lot of interest.

You see tons of capital who'd love to enter, but doesn't get access because there's a regulator here who'll be worried to give it to them, there are clients who don't want actually to give this to a hedge fund or a private equity group, et cetera. And at Swiss Re in the middle which has all the knowledge, the capabilities and everything, but potentially not all the capital to do significant transactions in this space. So, it's all about this puzzle and how to solve it and I think there could be interesting opportunities, and we're going to continue to explore these opportunities.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

And Guardian is sufficiently integrated now that there wouldn't be a lot of risk in buying another block, is that fair or?

A - Christian Mumenthaler {BIO 6479864 <GO>}

Yeah. Guardian is on track and you have to think about the lead times of anything. Obviously, if we found shareholders for the existing book that's not distracting anybody from a further acquisition. If it is about further acquisition, there's always a lead time of at least six months, if it's not nine months. And then if it's a separate legal entity and you do Part VII, you can also park it for one or two years or three years and then do it.

So I don't think we're, let's say, limited in doing a transaction and you have all the timelines, but the integration is not finished. But if I think about all of these pieces, I think fundamentally we can discuss about other transactions at this stage.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Great. Thank you.

A - Christian Mumenthaler {BIO 6479864 <GO>}

Thanks.

Operator

Our next question is from In-Yong Hwang, Goldman Sachs. Please go ahead.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Good afternoon and thank you for taking my questions. My first one is on the large transaction that you've been seeing. Just wondering from the demand side, what is driving these deals? Are they very much client-specific issues or do you see a common theme such as regulatory changes for the large deals that you've done in the last year or so?

And my second question is on the Life & Health. There is a comment in the presentation about an adverse experience in the Americas, just a bit more detail on what that is because I think one of your life reinsurance competitors in the U.S. has reported quite good U.S. mortality strength, so – yeah. Thank you.

A - Christian Mumenthaler {BIO 6479864 <GO>}

Yeah. So let me take the large transaction bit. There were various motivations, but I think the common pattern is, when you have a new CEO, new CFO taking over, they look at their whole portfolio, they look at what kinds of ROE they get from all bits and pieces, they have new plans to grow in certain areas, and they like to free up capital in all the areas, sometimes even if it's a loss, sometimes without generating IFRS or GAAP loss.

And then these transactions themselves can be all kinds of things. They could be adverse development coverage for P&C reserves for example, it could be a going-forward quota share that takes out business that has a high combined ratio if that's what bothers them, it could be a nat cap protection over several years or in aggregate on the nat cap programs, and aggregate meaning a program that adds up all the losses in the year and it's the sum of small losses in a year exceeds a certain amount we pay.

There are structured solutions that are very specific to the needs of a company, but generally it's for people who want to free up capital or take out volatility. It's not so much driven by Solvency II, let's say, or regulatory regimes at this stage. One exception to that is the big Life & Health transactions, they are sometimes driven by that.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Sure.

A - David Cole {BIO 7251632 <GO>}

Let me pick up the second question about experience on the Life & Health side. This one quarter doesn't really say a whole lot. You made reference to some other players who've referenced some positive experience. I think if you look back over the past couple of years more often than not, we've also had relatively speaking positive experience on the mortality, morbidity side. This quarter we had a little bit less positive experience versus expectation, but there's no real trend here.

The underlying business continues, I think, to perform in a way that gives us comfort regarding the – through the cycle type of return. We had 10.1% ROE this quarter, notwithstanding a higher equity base and notwithstanding some periodic adjustments that we do just going through and looking at the valuations, and as on top of that the quarterly negative experience versus expectations. So, I don't see anything in here that suggests something other than just a random volatility.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Sure. Great. All right. Thank you.

Operator

The next question is from Vinit Malhotra, Mediobanca. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Thank you very much. One on P&C and one of Life, please. On P&C, we will be looking at these nat cat pricing and noticing lot of comments in the industry that pricing is stabilizing a bit. So, I was a bit surprised to see that you're saying now that we are reducing nat cat in the U.S. (27:57) July renewals. Could you just comment a bit about, is this in your view the right time to reduce the U.S. nat cat? So that's the first question.

And then on the Life & Health, obviously we've seen the turnaround in Life & Health as a segment. But just going one step lower into the segment Life & Health separately, I noticed that health has shown some of the adverse effects that In-Yong just discussed with you, and the health EBIT is actually a bit lower than the recent history as well in this quarter.

So, just if you could comment once again, in 1Q you changed the ROE target definition from the old $5.5 billion equity base to current equity base, but equity base has again gone up by $1 billion or so in this quarter. So, in this whole context of health being a bit weakish depending on model updates and changes, you see 10% ROE to 12% ROE on a new current ROE still in place? Thank you.

A - Christian Mumenthaler {BIO 6479864 <GO>}

Okay, I'll start with the nat cat, while the others think (29:08) health questions. So, I mean when people say prices are stabilizing, I think that's a nice description for further decreases. So from a mathematical point of view, I would say the second derivative is turning positive, but not the first one, which means that the decline-after-decline is not happening anymore. So instead of whatever minus 10%, you now have minus 3%, minus 2% or minus 5%, but it's still negative.

And as you can see in our long-term price adequacy of 102%, we cannot afford much more. We're hitting the target of where we stop creating value for shareholders. And so, I absolutely told the team already in January, but now although preparing for the renewal, if prices go down further even if it's a smaller amount that we should scale back on the flow business further. We have already scaled back 7%, we've scaled back some of the U.S. nat cat and we will scale back that further if necessary. And I think that's the only right thing to do. So it's a question really of, if the margin is very thin, even a small decline makes it really uneconomic and we should be very consequential in that.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay.

A - Christian Mumenthaler {BIO 6479864 <GO>}

On Health, I don't know it's...

A - David Cole {BIO 7251632 <GO>}

Yeah, Life & Health. Let me just first start with the second part of your question, which is about the equity base. You're absolutely right, whenever we were, let's say, in the business doing the work that we had identified back in 2013, we said – we thought that by 2015 we'd be able to generate an ROE of 10% to 12%. So we're completely uncomfortable with what may happen with interest rates over that period of time. So we said, let's fix the equity base at that $5.5 billion.

Of course, we proceeded to implement those different actions, continue to write good business, put the right asset mix in place, dealt with some of this pre-2004 issue in the U.S., and then also finalize with putting the right capital structure in place for the segment.

Now, we're a couple of years beyond that. I think 2015, we were very pleased with the result. Also through 2016, we have an ROE of the quarter for 10.1%, but for the half that's still 12.6% I think off the top of my head. If you look more specifically, indeed the equity base has gone up, but we said that we thought that 10% to 12% would still be an appropriate target, independent if you will, somewhat of the equity base, I guess it's not without risk, that statement, but we think we also need to be able to give some sort of sense of confidence to our investors.

The health results in Q2, actually, there were some updates on the assumptions and valuations of course, had a negative impact in health. The actual experience for health in Q2 was positive versus our expectations. So, I certainly would not see something there to indicate a trouble in terms of performance going forward.

Just to reiterate, that 10% to 12% is a through the cycle target. We're not going to hit it every quarter. There will always be some volatility also in the Life & Health business. Just take a second to think about the absolute magnitude size of our in-forced book, as we go in order just to completely rigorous cost basis going through our portfolios on the basis of new data, on the basis of reviews of our model, assumptions that made from time-to-time need to be adjusted. There is always going to be some volatility, but we feel comfortable that the book as a whole has a good quality, and the underlying performance will continue to meet our expectations.

Q - Vinit Malhotra {BIO 16184491 <GO>}

All right. Thank you.

A - David Cole {BIO 7251632 <GO>}

Sure.

Operator

The next question is from Sami Taipalus, Berenberg. Please go ahead. Mr. Taipalus, your line is open.

Q - Sami Taipalus {BIO 17452234 <GO>}

Hello. Afternoon, everyone. Can you hear me?

A - Christian Mumenthaler {BIO 6479864 <GO>}

Yes.

Q - Sami Taipalus {BIO 17452234 <GO>}

Yeah. Perfect. Sorry, I think I had the phone on mute actually. Just first question on your liability business and some of the stuff that you've got in your reserve disclosures. If you look at the ultimate loss ratios, they tend to be in sort of mid-80%s to 90%s on the liability reinsurance. And if you add on the expense ratio to that, you get to probably around 120% for recent treaty years in terms of ultimate combined ratio.

I'm just – I just want – how that sort of the combined ratio makes sense in the current interest rate environment, because (33:34) you've been growing quite a bit recently, and I appreciate what was said before about it's being relatively capitalized when you're diversifying, but it seems nevertheless like there's pretty low level of profitability. That was the first question.

Then the second big thing I wanted to ask about was, the reserves and costs at this time, even if you strip out actually major large claims that you flagged, there still seem to be a little bit of adverse PYD in Q2 and there was a bit of adverse PYD in Q1 as well, which is quite a sharp turnaround from what we're seeing last year and the year before that. Is there any trend there or is this just sort of random volatility? Thank you.

A - David Cole {BIO 7251632 <GO>}

So on the second question, yeah, there is a small little bit of PYD excluding these. These two specifically also a little bit challenging in that regard, because it happened in 2015 and we only got real information about it this year. It shows up as a PYD, but in the general context the way we discussed, PYD is somewhat of a different animal.

If I look back over the last couple of years, we've had years where that's been positive, years where it's been negative, PYD, I'm talking about. There's little bit of a quarterly volatility around that. But if you strip out this $100 million (35:00) these two losses, a meaningless figure for Q2 for Corporate Solutions, so there's – I don't think there's really a story there.

But I'd to say, you've puzzled me a little bit with your first question and I don't exactly recognize some of the figures, but maybe we can take it offline to go into a little bit more detail of about a specific line or specific year that we're referring to. But just in general, we recognized it from time-to-time the combined ratio on a reporting year basis can sometimes even go above 100% and still be an attractive book of business to write. But I don't think it would be appropriate sense that you may have that somehow we're sitting on the serious lines of business or reserves, where we're expecting an ultimate loss somewhere in the range of 120%. I think we can follow up, if you don't mind, offline but I don't recognize that.

Q - Sami Taipalus {BIO 17452234 <GO>}

Well, it's really isn't anything complicated. If you look at the slides in your reserving presentation, I mean I may have misread this. But where it says ultimate loss ratio, it's kind of between 85% and 90% roughly for all [Technical Difficulty] (36:09) since 2007. I mean, your normal expense ratio is around 30% to 35%. So if you add those two together, you get to somewhere around 120%. So, I mean that seems quite a bit above 110%, so I'm just wondering why? And there's no [indiscernible] (36:30)

A - David Cole {BIO 7251632 <GO>}

There could be individual - yeah, I mean I can pick any one of the different slides, I'm happy to go through it in detail. There's some years of course in soft markets, where you do have ultimate loss ratios in excess of 100%, but if you look at the overall book across the different accident year, treaty years, you'll see I think a very consistent figure below the ultimate loss level of a 100% on the book.

So, there may be individual lines, individual years that have experienced of course the ramifications of soft market environments. But one thing I can tell you is that, consistently across our book with the exception of recently some updates on the motor side and of course the ongoing story around asbestos in United States, particularly we remain I think very comfortable with the way the existing reserves are developed and the overall level of prudence associated with that.

As I mentioned, typically we sit somewhere between 60% and 80% of the best estimate range. Notwithstanding the fact that over the last couple of years, for different reasons, we've had some prior-year positive development, actually in the overall positioning within the range we have not gone down. So, we basically stay flat or even in some lines of business has moved up a little bit.

Q - Sami Taipalus {BIO 17452234 <GO>}

Yeah. All right. Okay.

A - David Cole {BIO 7251632 <GO>}

We're happy to follow-up afterwards, if you don't mind.

Operator

Our next question is from Thomas Fossard, HSBC. Please go ahead.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes. Good afternoon. One question left on my side, which will relate to the other rates you've got in mind regarding any, I will say, big deals or acquisitions or ability to deploy excess capital. In the back of my mind, I've got an 11% other rate which probably days from couple of quarters back. Is there any change in your thinking of how much is (38:31) right now? Are you still looking for 11% or has it changed in light of the new interest rate environment? Any update on that. Thank you.

A - David Cole {BIO 7251632 <GO>}

Quick answer, no. No, it hasn't changed. Obviously, that's the kind of thing that from time-to-time you may have to review. But we continue to believe that for large allocations of capitals, I'm not talking about every individual transaction that we do, but certainly for large allocations of capital that having that type of rule of thumb, if you will, 11% ROE on a U.S. GAAP basis, is not a bad thing to have, of course we look at transactions using a number of other metrics.

And as you correctly indicated with your question, at some point with low interest rates and overall lower available returns, it may not be the appropriate number to continue to apply. So for the time being, as Group CFO, I continue to apply it relatively rigorously.

A - Christian Mumenthaler {BIO 6479864 <GO>}

I think maybe one thing to add is, if you write casualty that's on a GAAP basis, but on a PV basis. So, you could have a large casualty transactions where in the first year you have to setup reserve (39:40) high and then you have the interest rates coming through for seven years. So, it meets 11% overall on a PV basis, not necessarily in the first year. In every large transaction, we have a document and in the document we see the whole EVM view and a whole GAAP view over time year-on-year, and it has to meet this 11% hurdle.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. Can I take from your comments that the transaction, the last transaction with AIG at the start of the year was based on this type of metrics, because I think that there were some comments in the market saying that, potentially you may have taken this deal on relatively low profitability level. So typically, the size of the transaction with AIG (40:30) to this kind of other rates?

A - David Cole {BIO 7251632 <GO>}

I have to say, we're extremely happy with that particular deal, but we look at different metrics, right. We look at it – we don't look at accounting year combined ratio being great every single year. We look at overall on the economic basis, EVM and also GAAP, how will this accumulate. So what is the – if you want the PV combined ratio, the present value combined ratio, and that was attractive for that particular deal.

So (41:01) and I think that's where you get interesting transactions. Win-win transactions is when two companies have different KPIs, they try to optimize then and there are in different regimes, then you have interesting opportunities. And so, I'm sure they're very happy with the deal and we are very happy with the deal and that's possible.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. Sure. Thank you.

Operator

The next question is from Philip Kett, Macquarie. Please go ahead.

Q - Philip Kett {BIO 19507232 <GO>}

Good afternoon, everyone. Just one final question from me. On the Life & Health Reinsurance business, there is a comment in the presentation about successful renewals in China and Australia. Is that now a significant portion of the business? Thank you.

A - Christian Mumenthaler {BIO 6479864 <GO>}

So, it's not that significant, no, because we have some renewal business also in Europe by the way, but that's one-one. It's not a big part of the business, not driving it.

Q - Philip Kett {BIO 19507232 <GO>}

Thank you.

Operator

Our next question is from Frank Kopfinger, Deutsche Bank. Please go ahead.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Good afternoon, everybody. I have two questions. My first question is on the P&C Re combined ratio. Could you elaborate a little bit on the underlying trends. And I'm thinking specially about either on your adjusted way – the way from the 95.6% that we had in Q1 to 102% almost now in Q2, but you could also do – you strip everything out like the reserve releases, nat cat, man-mades and so on. Do you see the hiccup in Q2? And could you walk us through this increase, what the drivers are here? I think especially on (42:56) by the shift mix, by seasonality and also by the expenses, if you took on the combined ratio?

And then my second question is on your buyback. Now that you've upstreamed $3.5 billion of dividend through the holding, you've generated $1.9 billion in profit, have still leftover of $850 million of nat cat budget. What could derail you really now to the buybacks for next year or this year?

A - David Cole {BIO 7251632 <GO>}

Listen, there are all sorts of different scenarios about what could happen in the remainder of the year that may lead us to conclude that there are better usage of capital than on the buyback. It could be losses that occur, real losses, so independent of what we have in our budget. Windstorm takes place somewhere in the North America, somewhere in Europe, earthquakes somewhere around the world, could be opportunities that arise to invest capital.

So, I think I'd just go back to my earlier comment about the way in which we think about capital and the hierarchy that we think about it. But as we get towards the end of the year, if we find ourselves sitting in a situation where the amount of capital we hold is in excess of that that we think we should reasonably hold to continue to be able to respond to opportunities that arise, then we'll think about the best way to return that excess capital to our shareholders.

As for your first question, there's really not a whole lot more that I can add, there's seasonality of course, every individual quarter is a little bit different. Our business mix continues of course to evolve a little bit. It's also a business that we've written in previous periods, previous renewals now flowed away through our P&L in terms of earned premium and loss expectations.

We've walked you through earlier a little bit the way that we think about our large nat cat budget, and in fact that is not exactly linear throughout the year. We've provided with some information about the actual versus expected nat cat and the prior-year impact. I don't really have a whole lot more to add in that in terms of granularity or insight, other than I would just caution you that the 99% estimate is an estimate for full year. There are a number of things that can move to change that over the course of the year. We still believe after two quarters that it's an appropriate number. I think the actual adjusted – we are adjusting for the expected versus actual and the prior accident year development coming in at just under 99%, so just shy of the 99% estimate is at least some indication that the number may not be too far off, but time will tell.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay. Thanks.

Operator

Our next question is a follow-up by Vinit Malhotra. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yeah, sorry. Thank you for taking a follow-up. I just wanted to just check on these two losses in California that we are talking about today. How does Swiss Re normally look at a loss? I mean, if the loss occurred in 3Q 2015 or 4Q 2015, then should it not be the case that it should be reserved to some magnitude back in those quarters? I mean, I just want to understand how does reserving philosophy works be, if you don't mind? Thank you.

A - David Cole {BIO 7251632 <GO>}

No, that's perfectly fair. And the short answer to your answer is, yes. The specifics of these two losses however meant that both the responsibility for the losses – these were not property losses, these were casualty coming through liability. So the determination of responsibility for the loss and also determination of the magnitude of the loss didn't actually take place, it wasn't possible until effectively in Q2.

So it wasn't possible at the time that the events actually started or occurred. But in principle, you're absolutely right. I mean this is one of the things that makes us somewhat unusual. In fact, we have two of these now in the same quarters, even more unusual. But rest assured, we've looked into this quite closely to see as Christian indicated, there are some sort of trend. And the only thing that we can really see is the fact that both of them are in California, so that's completely unrelated to each other. The circumstances just developed in such a way that we didn't have a view of the loss back in the quarter when they've been occurred. Now it became quite clear to us, specifically also this culpability, the responsibility issue during the course of Q2 of this year.

Q - Vinit Malhotra {BIO 16184491 <GO>}

All right. Thanks (47:39)

A - David Cole {BIO 7251632 <GO>}

Sure.

Operator

Our last question is from Vikram Gandhi, Societe Generale. Please go ahead.

Q - Vikram Gandhi {BIO 6133175 <GO>}

Hi. It's Vikram Gandhi from SocGen. Couple of questions. One is on the amount of short-term investments and the cash that you hold. If I look at the total of these two elements, the short-term and the cash, it's about $17 billion plus. I appreciate it's come down a bit from the last quarter, but it still looks substantial. So, any thoughts around how you intend to deploy this cash and translate into some form of running investment income, would be helpful?

And the second is related to the Life & Health Re business. About three years ago, you did a cleanup of the book particularly with regard to the YRT and PLT. So can you give us some comfort around the PLTs. So let's say, couple of years down the line (48:45). We wouldn't have another cleanup exercise I think in a year or two? So those are my two questions. Thank you.

A - David Cole {BIO 7251632 <GO>}

Yeah, thanks. So, I'll take the first and Christian will maybe pick-up the second. So, you're right, you're looking at slide 29 I suppose, you see the cash and short-term investments. We still hold a good cash position unless we more or less match in terms of overall asset liability management. We're currently I think minus $2.9 billion DVO1.

We have been actually moving some cash into government bonds, as you see that number has gone up a little bit, as well as in the short-term investments which are typically also short-term government paper. But you can imagine, not government paper with a negative yield, the government paper that still has a positive yield, albeit those papers are also becoming fewer and far between and the yields are becoming a little bit less.

There remains a little bit of quagmire, we have no intent to start putting a lot of cash in vaults or cash in mattresses or anything of the sort. We're looking for good quality credit, we want to maintain the overall asset allocation ranges that we've previously indicated. Actually during the course of Q2, we took a little bit of risk off the table with the equities and alternatives. We continue to look for opportunities to invest in high-quality assets, but it's hard for me to say exactly where that cash will go. We're not going to go chasing yield, that's for sure. We continue to hold a good cash position, no doubt, at least for the foreseeable future.

A - Christian Mumenthaler {BIO 6479864 <GO>}

Yes. In terms of PLT, that is post-level term issue in the U.S. on our old book of business, I think nothing has changed over the last two years. So, it continues to be a drag, it will be a drag going forward. We have a whole team mitigating it. So that's I think what we talked about at the time of Investor Day, and that's going quite well. The team by working together has declined and mitigated by having basically more people staying off the PLT period with decline, which is better economically for the client and for ourselves. But it can't mitigate it completely away.

I think the relevant thing for all of you and our investors is that we have taken that into account into all of our projections and the 10% to 12% ROE we want to achieve. So it just means we have used the time and continue to use the time to add on more good business and do large transactions where we can, so that we can stay within this 10% to 12%. So, if I could – if I was a magician, if we could get away with that business, I would immediately get rid of it, but it's not possible. And so, we just work with it as we do to whole in force book.

Q - Vikram Gandhi {BIO 6133175 <GO>}

Okay. I appreciate that. Thank you.

A - Philippe Brahin {BIO 19081619 <GO>}

Thank you. This is Philippe Brahin, again. So we've come to the end of our Q&A session. Thank you very much all of you for joining. And if you have any follow-up questions, please do not hesitate to contact any member of the Investor Relations team, and (51:50) will follow-up with you on the P&C reserve book as David mentioned. So, thank you again everyone for participating today.

Operator

Thank you for participating, ladies and gentlemen. You may now disconnect.