Q4 2017 Earnings Call

Company Participants

- George Quinn, Group CFO and Regional Chairman of Europe, Middle East & Africa
- Mario Greco, Group CEO
- Richard Burden, Unknown
- Unidentified Speaker, Unknown

Other Participants

- Andrew Hughes, Insurance Analyst
- Andrew James Ritchie, Partner, Insurance
- Dhruv Gahlaut, Analyst
- Farooq Hanif, Head of Insurance Research in Europe
- James Austin Shuck, Director
- Johnny Vo, MD
- Jonathan Peter Phillip Urwin, Director and Equity Research Insurance Analyst
- Michael Igor Huttner, Senior Analyst
- Nadine Adrienne Marion van der Meulen, Equity Analyst
- Peter Eliot, Head of Insurance Sector Research
- Ralph Hebgen, SVP and Senior Analyst
- Thomas Seidl, Senior Analyst
- Vinit Malhotra, Banca di credito finanziario S.p.A., Research Division

Presentation

Operator

Ladies and gentlemen. Good afternoon. Welcome to the Zurich Insurance Group Annual Results 2017 Conference Call. I am Alice, the Chorus Call operator. (Operator Instructions) The conference must not be recorded for publication or broadcast. At this time, it's my pleasure to turn over to Mr. Richard Burden, Head of Investor Relations and Rating Agency Management. Please go ahead sir.

Richard Burden {BIO 1809244 <GO>}

Good morning. Good afternoon, everybody. Welcome to Zurich Insurance Group's Full Year 2017 Results Call. On the call today is our group CEO, Mario Greco; and our group CFO, George Quinn. Before we start with the Q&A session, I would just hand over to Mario to make a few introductory remarks to the results. Mario?

Mario Greco {BIO 1754408 <GO>}

Thank you, Richard. Good day to all of you ladies and gentlemen. And thank you for joining us. Let me make a few remarks before George and I get to your questions.

First of all, I am very, very pleased with our full-year results. I'm pleased because to demonstrate that we're making progress against the target that we set in November 2016. And we're getting traction in achieving these targets. '17 has been a challenging year. So nothing has been really easy and which makes our achievement even more relevant, especially given the weather events that we faced.

Expense plan is well on track, as we wished it to be, $700 million of -- achieved to savings at the end of '17. I think it is a good demonstration of the discipline that we have been introducing and we follow through the years. And it talks well about what we will deliver over the next two years.

The Property & Casualty business has clearly improved in the second half of the year. The top line is not just stabilized but is growing again. The composition of the new business through '17 has been what we wanted to achieve, which also says that we have reestablished clear communication of our strategy, of our appetite, of our underwriting priorities with the markets and with the brokers.

The underwriting performance has also moved for better. The accident year loss ratio shows improvement. And the same is for the other underwriting expense ratio. I'm also pleased to see that our reinsurance program, which we changed a year ago, has worked less and has protected effectively the capital and the P&L of the company in such as last year.

We are definitely focused on improving the underwriting performance. On underwriting, we're pleased. But we know that the journey is a much longer one and that we have to continue making improvement. But we're confident now that we know what the improvements are and that they can be achieved. Pricing is getting better. We do see positive pricing movement, especially in North America. And we expect this to continue during the year and to give us some good support.

Life had an extremely strong year. BOP is at 11%, even taking into consideration in that the U.K. recent changes on taxes of the unit-linked product. The product mix has improved. And this has sustained our margin growth in the year. And the new business value has increased.

The bank distribution, which has been a strength of Zurich, has continued to be very successful. The South American business has further developed. The Spanish business with Banco Sabadell has also grown very nicely. And we added, at the end of the year, a new business in Australia with ANZ bank, which we think will perform equally well starting from this year.

Farmers had a very tough year, especially for the natural catastrophes. But through this year, they have improved combined ratio very effectively. And they ended the year with much better customer results, customer satisfaction and retention. And they reached the highest historical peak of customer satisfaction at Farmers. Premium growth has been very successful. And again, all this evidences support us in being optimistic and confident on 2018 and following year.

Capital has always been the strength of Zurich. And still at the end of '18, our capital -- '17, our capital position is very strong. The Z-ECM is at 132%. And of course, we will continue managing our balance sheet in an active way and we will continue looking for ways to further improve our capital position.

Now coming to capital and to the decision we proposed yesterday to the board. The most visible and relevant one is about the increase in the dividend. You all know that George and I have been speaking about raising the dividend since November '16. We knew this was in the plan. We're pleased to see that we can do this already this year. But we knew that this was achievable for us anyway.

The reasons that we gave to the board were the strong performance of '17. But even more, the confidence we have in further improving this performance in '18 and in the following years. The business is getting better. We're getting better traction on the business. And these are the 2 elements that convinced the board to approve the proposal and bring it to the AGM. We also proposed a change in the capital policy in order to avoid dilution to shareholders from the past and for the future. And again, the board has supported that as it was a policy for shareholders' right.

Just to sum it up, before I leave it to questions. We are pleased with the results. We think that we are delivering on what we promised to you. And we have confidence that this will continue in '18 and in '19. And we will continue delivering on the targets that we announced to you in November '16.

I'd like to stop here. And George I are happy to take all your questions.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Farooq Hanif from CrÃ©dit Suisse.

Q - Farooq Hanif {BIO 4780978 <GO>}

Given the statements that you have made about your confidence on the 95% to 96% combined ratio, where does that leave us in 2018? I mean, to ask in a clunky way, do we just assume that you're kind of halfway there? And to what extent does the expense ratio play a part now in that? Then very quickly on the Life business, it looks like if you add back the U.K. one-off that you're getting to the $340s million, $350 million-ish run rate. Obviously, we have to take currency into account and the rest of the factors. But where would you say run rate is and the growth prospects for that?

A - George Quinn {BIO 15159240 <GO>}

Farooq, it's George. I'll take those. So starting with the combined ratio topic. And just a reminder for everyone that we're looking for a combined ratio of 95% to 96%. And by 2019, given the plan that we've got, I guess, it might be a bit generous to say that we're halfway there. I think if you look at the results, I mean, the strong -- in almost every single corner other than this area around the P&C result where we're not quite yet where we want to be. And I think if you look at it, I mean, the biggest challenge within it is commercial. It's a topic that we had already started to look at in depth as we put the plans together for '18. So this was back in September. We've all worked hard with Jim Shea on what changes of the client and the portfolio to really drive the improvement that we need to see. I mean, if we can see a number of areas where we can make significant changes, those are step that we put in motion already. So -- and this is the year we expect to see significant improvement. I'm going to avoid giving combined ratio guidance for 2018. I think it's important to focus on what we're trying to get to overall. I mean, if you look at the entire business, we've obviously benefited from a very strong performance within the retail and other (inaudible). But commercial is the one standout area we've got more work to do. Expenses will certainly help contribute. I think we still have $800 million to go. You can expect the bulk of that to fall under the P&C. And as we've talked about before, that's what -- they're only a couple of point on the combined ratio. But overall, from a technical performance perspective, we do still expect to see improvement from where we are now.

Q - Farooq Hanif {BIO 4780978 <GO>}

So just to quickly follow-up on that point. So you think the expense ratio have had mixed effects, which make it look like it hasn't gone down even though it still has. But do you think that will now start to show a lower ratio going forward?

A - George Quinn {BIO 15159240 <GO>}

So I think if you look at the ratio, over the course of the year, you see a reduction already. If you look at the -- I mean, the different components we've got about a 1 point reduction on expense, 1 point on the accident year loss ratio and about 1 point up on commission as the mix change. We're certainly late overall on PYD compared to our normal expectations. We're in the range. But slightly low in the range. And of course, you all know why that is. That's because we resolved it over the course of the year. I mean, having said all that, I do expect to see the expense ratio improve. I mean, there will still be some mixed movement. But we're also expecting to see a technical improvement. So loss ratio improvement. A continuation of what you've seen already on the accident year loss ratio with particular focus on commercial.

A - Unidentified Speaker

On the Life BOP topic. So -- the numbers, I think, we would be slightly more cautious on Life. So that means the guidance we're giving today is -- I think, if you look at the headline number, I don't backout the U.K. yet, starting the headline number and anticipate something in the mid-single digit of the group. That would be okay, actually.

Operator

The next question comes from Nadine van der Meulen from Morgan Stanley.

Q - Nadine Adrienne Marion van der Meulen {BIO 15200446 <GO>}

I suppose, firstly, on Life, the new business value, very strong. The margins was particularly up to 23.3%. Can you talk to us about how sustainable you see that being? Second question on excess capital, the 132% at Z-ECM. Mario just mentioned you're looking for ways to improve the capital position. I suppose it's not optimal, the 132%, because you shown on slide 37 the target of 100% to 120%, which -- I mean, if you translate that into dollars, it's at the midpoint of that. You're talking about a $6 billion, $7 billion excess. So perhaps you can elaborate a little bit more on that? What your plans are there and over what time period? Then, lastly, on the U.S. commercial side. So the premiums in large commercial were down. What should we expect in terms of volume growth going forward? And are we seeing rate increases? Competitors have shown similar indications. So what is the outlook in terms of claims inflation there relative to these rate increases?

A - George Quinn {BIO 15159240 <GO>}

So I'll start with new business value. I think, if you look at the detail picture on new business value, there are 1 or 2 items that we received more one-off in nature. So we have a restructure of our large corporate contract in the U.S. But I mean, by and large -- I mean, the biggest driver of what we see is combination of economic variance. So the interest rate environment has certainly helped last year. And then mix. So I mean, we have an improved mix, particularly in Europe. And that's a combination of factors (inaudible) actively selling some of the higher-margin products. That enhances some of the lower margin, higher volume stuff that we did in 2016. And we talked about it before. So I think, with one exception, I mean, most of it is something we would anticipate selling to current environment we can continue to drive. On the capital topic. So you've seen today that we've announced (inaudible) including the impact of the share repurchase for the anti-dilution program. And as you pointed out, that's still well ahead of our target capital level. I mean, our capital management policy is completely unchanged. I mean, we'll continue to do the same things as you've seen us do before. Our priority would be growth. If the growth exist, then that growth can be either organic or inorganic. And absent that, if we really can't really find ways to deploy the capital into the shareholders, we will look to return it. But obviously, we prefer to find the growth if we can.

A - Mario Greco {BIO 1754408 <GO>}

All right. On the business to premiums and the claims, Nadine. So first of all, we don't see much evidence yet of an inflation creeping up or developing itself. The claims numbers are quite stable. And frequency is falling down and the cost of the claims is fairly positive. So it's all very quiet for what we've seen so far. On the premium side, I mean, we see movements in North American property rates, definitely. The market has alerted all of you on that. And we just see that ourselves. We don't know for how long this would continue. But definitely, it will be through this year. The growth that we see coming is, it comes from 2 different sources. First of all, we are gaining back in retention rate. So we're doing much better than in the past years in renewing with the customers. And the other thing which we've been quite successful across '17 and we plan to continue is developing the lines that we're pursuing. So we would have been growing on specialties quite successfully. We have been growing on credit lines. So short-tail business has been successfully targeted by us during '17. And we will continue growing on this businesses through '18. But the message that underwriters have is to grow the profitability. So to go for bottom line, not to go for top line. And we're happy to get top line moving positively. But we target the priority that the underwriters have. And it's on the bottom line result of their lines of businesses.

Q - Nadine Adrienne Marion van der Meulen {BIO 15200446 <GO>}

Just a quick follow-up on the growth. As George mentioned, the growth organic or inorganic. And Mario, as you said, you've targeted short-tail lines. Is that sort of the P&C short-tail lines that I should be thinking about when you're talking about that growth organic or inorganic?

A - Mario Greco {BIO 1754408 <GO>}

Yes. I'm really meaning organic growth. So we have been doing since 2016 is to be very clear internally with our underwriters and externally with the brokers, with the distributors, on which targets we would like to go for and also which, if any portfolios, that we will not like to underwrite. Consequently, we saw the new businesses rather shifting and we're quite happy with the composition of new business that we saw coming through 2017. And by having had already meetings with all the main brokers through January, I could say that they will understand what we want. They will appreciate what we are after for in 2018. And I think they would support us in growing in the lines of businesses that we're targeting.

Operator

The next question comes from Peter Eliot from Kepler Cheuvreux.

Q - Peter Eliot {BIO 7556214 <GO>}

The first one was just on the group underlying. And you've given us the underlying thought, I'm wondering if you could also just share your view on the underlying net income between '17? Just for us to gauge on how the dividend and how that ratio compared to the 75%? And secondly, on the Life. I'll take your comments earlier. I was just looking at Life Asia-Pacific, in particular. What was about -- it was nearly $100 million in H2. But a lot stronger than it's been before. I'm just wondering if you can comment on that specific. Was there any one-off in there? What we should expect there going forward?

A - George Quinn {BIO 15159240 <GO>}

Peter, thank you. So the -- we've done quite a few underlying and adjusted numbers. But I haven't done one on NIAS. I mean, I think, if you look at the numbers and you look at the history, I mean, I think, you can see that the realized gain component can be plus or minus quite a lot depending on what's happening on the asset allocation. And the important thing that would stand out has been an obvious one-off in the results. But NIAS perspective was not involved as the impact of tax reform on the detail position that we had, maybe go about $290 million. I think trying to normalize NIAS is really quite difficult given the nature of the things that drive NIAS. I think if we try and take a longer-term view, we expect BOP and NIAS to be in line. And typically, NIAS will be slightly higher because, of course, there we pick up the -- I mean, the spread beyond the -- or the return beyond the coupon that we achieved within BOP. On the second question, on new business value. I mean, generally, it's been a very strong year for new business value in Asia. We've seen both Japan and Australia perform strongly. I mean different drivers in the 2 different markets. I mean, for Australia, it's been the growth of the overall portfolio that's mainly driven, of course, by the cycle that we bring on (inaudible) transaction after the acquisition a bit more than a year ago. On Japan, it's different. I mean, if we went back in the early part of the year to look at -- I mean, obvious there's the profitability in some of the products and the riders. And based on the experience that we've seen before in the more positive view. So we've listed the view of profitability. I'm not aware of substantial one-offs in Asia-Pacific.

Q - Peter Eliot {BIO 7556214 <GO>}

And just to clarify, it was actually BOP for the new business. But I was -- I was asking about that.

A - George Quinn {BIO 15159240 <GO>}

So from a BOP perspective -- I mean. So for example on the new business value topic around Japan, I mean, that -- well, have had some small positive impact on BOP that is more one-off in nature. I mean, that's not a substantial number than the overall weighted performance.

Q - Peter Eliot {BIO 7556214 <GO>}

And just quickly back, perhaps, on the first point. I mean, I guess, I've sort of understood the dividend policy was really driven by your view of underlying net income. I mean, it sounds like this year it's more a qualitative assessment rather than a quantitative one and that's on specific payout ratio. And that the payout ratio will apply more going forward. Would that be fair?

A - George Quinn {BIO 15159240 <GO>}

Not quite. I mean. So what we did in the conversation we had with the board, actually, only yesterday, we build up a model of -- we start with the operating profit and then run through to what we think the equivalent NIAS number would be. And we take it -- I think the obvious thing is we expect to (inaudible) so its things like impact of restructuring, the things that we've talked about already. And the operating profit. And we've looked at the totality all of the other movement to try and form a conclusion as to whether we think there's another item we should exclude or not. And the only significant adjustment that I made to the -- this model NIAS number for the board was to note realized gains then to a number that's probably more consistent with a longer-term expectation than the signal that you see in the results today. And so -- I mean, this was not a qualitative decision, this was a hard decision based on the combination of what we think we achieved last year. And actually, more importantly, what we think we're capable of achieving this year.

Operator

The next question comes from James Shuck from Citi.

Q - James Austin Shuck {BIO 3680082 <GO>}

I had a few questions, please. Firstly, I just wanted to come back to the loss ratio improvement. So George, you all (inaudible) BOPAT ROE -- well, the famous one, which you update now for 2017 through to 2019. If I compare that with what was going at the time of the Investor Day, there was no 0.5 to 1 point of loss ratio improvement coming through -- planned by 2019 from the Investor Day. That's now at 50 basis points from 2017 to 2019. So it's come down a little bit. I guess, when I look at the accident year loss ratio improvement, that actually improved by 1 point over that same time frame, which is roughly what I would have expected over the whole planning period. So my question on the loss ratio is, are you running ahead of what you were planning there? Are there losses distorting that number still in any meaningful way? And secondly, on the ROE target itself. So you kept getting away from this 12% BOP ROE number target, which actually hasn't been changed even though we've had the U.S. tax reform and also you've been deploying capital via acquisitions. You've got 14% target by 2019. But that includes drag from buildup of equity in particular, which presumably you'll do something about. So my question is really, is that an appropriate target level. I mean, you -- the 14% should presumably be rising issues to deploy surface capital. Is this a number that's going to come down over time or is it kind of a floor level? How should we think about the volatility on that going forward? Then, finally, just a quick one on the efficiency side of things. So you're halfway -- not halfway, ahead of the plan by 2019. Anyone can hit an expense ratio target if they put back on certain discretionary spend. You haven't shared any insight into what your discretionary spend on digital and data or another initiatives has been and whether you've actually been containing that in any way, please?

A - George Quinn {BIO 15159240 <GO>}

Well I'll try to keep the answer as short as possible. So on the loss ratio improvement, I think you're right.

A - Mario Greco {BIO 1754408 <GO>}

But don't be short on the capital target.

A - George Quinn {BIO 15159240 <GO>}

The ROE target.

A - Mario Greco {BIO 1754408 <GO>}

Yes. Don't be short on that, please.

A - George Quinn {BIO 15159240 <GO>}

I mean, I think, you're right on the analysis that the comparison of where we are to what we had up on the slide back at the end of '16. But I mean, I think, everyone can see from what I've told you to expect and then what we've actually delivered, we're short against the expectations on the P&C performance. And we still have a lot to do there. So I think the -- but we're still targeting to get it to 95%, 96%. Expenses is still the biggest part of that. We have made a lot of improvement. I think maybe more than the 98.2% we necessarily suggest today. But -- I mean, we look at the commercial performance, I mean, we appreciate it's a difficult market. But we want more. We want a greater ton of the capital invested in our business. And James Shea and the team are well aware of that. And they're working on it. On the ROE topic. So I think maybe an important point to make is that when we did the -- again, we did the investor presentation back in November '16, we said more than 12%. Maybe that's a bit cute. But I think we had -- we certainly had a 13% written on the slide somewhere. So I think the expectation was that we start slightly over 12% and we drive it higher over the period. Now we're resisting the temptation simply to revise up around the target. So I think it's important that we try and we maintain the integrity of what we said at the beginning. But I think we can all see that from a combination of -- I mean with the progress we've made so far, what we're going to do around the Australian acquisition plans, most recently the impact of U.S. tax reform. I mean, simply, mathematically, that won't make our performance better than the one that we had planned for. On the (exit) drag side of things. So -- I mean, we have less there in the chart. I mean, we're handing back in the form of the dividend and the anti-dilution and share repurchase. And that's a pretty chunky piece of capital. Last year, we also invested quite a bit. It's important to remember about -- almost $3 billion. Let's see what happens there. I mean, we want to use the capital wisely. We don't intend to do anything that's (inaudible) to shareholders around the -- I think no pressure from a performance perspective to do something. It's been -- we have to find a way to use it or we'll look at returning it. I mean, same policy as before. On the efficiency thing. So maybe I take issue that anyone can have an expense target of, I think, (inaudible) very few people could have an expense target. I mean, again, if I ran you a bit through the history of what we've done here, I mean, we started with the easiest stuff. I mean, discretionary was the first thing that Mario asked us to tackle when he arrived back in February '16. Just to get fiscal discipline into the organization, a little long past discretionary. And if I turn to technology side of things, I mean, a large part of what you see by way of restructuring last year. And you see this unusual thing where we got part of the research and charges and NIAS. And part of it is in BOP. And the reason for that is that some of this results investing in technology to reduce expenses in '18 and '19. So I don't think we've done anything that is not sustainable around expense. In fact, as I look around the organization, I think, the -- we actually operate far more effectively for being later. And I think, we can take that a bit further still as we achieve the remainder of the goal. It's not driven by a starving investment in digital side. Quite the opposite.

Operator

Our next question comes from Andrew Ritchie from Autonomous.

Q - Andrew James Ritchie {BIO 18731996 <GO>}

First of all, thanks for the dividend increase. I'm just moving to the questions. The commercial lines unit, I guess I had hopes you could improve the attritional performance there in '17 given all the issues that you were tackling. I'm a bit surprised it's deteriorated by nearly 2 points. Could you just clarify, where exactly are the problem books? Is it U.S.? Is it -- it looks like it's partly colored in Europe, I think? Is it also a liability? A financial line in (DNO)? Are we talking about a couple of lines in this disproportionately high combined ratios. I appreciate you're still trying to improvement it. But I think the degree of improvement was disappointing in '17. Second question, tax. What were the negatives from U.S. tax reform? Are you going to have to keep more P&C business onshore U.S.. And will that affect fungibility, ability to upstream cash, et cetera? And related to tax, what's the kind of long-term tax rate of the group going to be? And I think part of the reason the group tax rate is still high is because of weak P&C profitability in Europe. Imagine that was the normalized and aligned for U.S. tax rate. What would become an ideal 2019 and almost tax rate kind of be for the group? Then a follow-up question is just a clarification thing. On the anti-dilution, is that now ongoing? I appreciate you doing some historic catch-up and the next couple of years of options. But is that now an ongoing commitment as far as employees share options are concerned?

A - George Quinn {BIO 15159240 <GO>}

Thank you, Andrew. Yes, I like that -- I mean, we have tried to (inaudible). But I share the disappointment on the commercial side of it. I think if you look at what drives it, I don't see that we have new issues. I think we have some of the same concerns. Auto continues to be a problem. I think if you look at it -- if you look at the rate entries it shows up possibly, the most attractive line of business bar none from a rate perspective. But unlike a retail also in the U.S., we don't see the change in claim chains that the retail side has been experiencing. So the improvement there have been far slower than we'd anticipated. And we do intend to take action around how much capital we allocate in that line of business to drive a more rapid improvement. I mean, besides that, we had issues back in '16 around financial lines. There are still some of those mainly in Europe in 2017. I mean the issues, overall, are no different. The front driver (inaudible) the term that we have here. So I mean we are focused on it and we expect one to prove it (inaudible).

A - Mario Greco {BIO 1754408 <GO>}

Can I jump in? Because I hear you. And I don't disagree on the results. However, I think, I always, always repeated that these are big books. And they don't change one year from the other. The issue is the book composition. You move it year after year, which is what we're doing. And the books are getting better. And the books are moving in the right direction. But it takes years. I mean, it wasn't as simple as because there was a one chunk which was underperforming. If you run with a high 90 combined ratio, it is because of book composition. I mean, the Zurich underwriters are not more stupid than the underwriters. And actually, I think, they're skilled and prepared. In order to achieve better combined ratio, we have to compose the books in a different way, which is what we started in '16. We progressed in '17. Now we're going to have the compounded effect of two years, plus the new business of '18. Kicking in on the year-end results of '18. And this will progress as towards the targets that we announced. So I wouldn't be that negative, although I understand. And of course, I agree on what you say. But the other perspective, please, that we are shifting the book composition towards shorter tail lines towards a different -- and if you look at the new business development of '17, that clearly shows it. And this will start producing gradually year after year the results that we're looking for.

A - George Quinn {BIO 15159240 <GO>}

On the tax. So on -- negative from U.S. tax reform. So maybe, again, just for everyone's benefit. I mean, we clearly have the change in the rate. We have an element of the structural change, which is P&L for a cross-border transaction. And of course, that's problematic from a global insurance perspective because we like to carry risk back to where we have most of the capital, which is back here at home. We took steps as of Jan 1 to change some of the end-tail structuring. That means that we no longer have the same quota share in place from the U.S -- or out the U.S. But that will slowly build premium volume in the U.S. and of course, we have to carry capital to support that premium volume. Not everything is precisely clear at this stage. So with that caveat, I mean, at this point, we would anticipate that by and large, any negative cash fungibility issues will be financed by the positive cash issues this thing also generates. So over the next, say, 2 to three years, one will finance the other. Then once we fully finance the capability to hold more of the risk. Luckily, we'll get a pickup in the group's overall cash flow. In the short term, one finances the other. On the anti-dilution topic, yes, the intention is this will be something that we will do consistently in the future.

Q - Andrew James Ritchie {BIO 18731996 <GO>}

And the long-term tax rate?

A - George Quinn {BIO 15159240 <GO>}

Sorry, long-term tax rate. So the...

Q - Andrew James Ritchie {BIO 18731996 <GO>}

Beyond '18, I mean?

A - George Quinn {BIO 15159240 <GO>}

Yes. So the -- I mean we talked before it had a 29 type rate. I Mean, this is a 3 point improvement over that long-term perspective and maybe even a point beyond that?

Q - Andrew James Ritchie {BIO 18731996 <GO>}

All right. And the 29 those still factored in relatively low possibility of P&C, isn't it?

A - George Quinn {BIO 15159240 <GO>}

Yes. So -- I mean, you mentioned there's a mix issue in it that the -- we're seeing more of a contribution come from, example, from -- Farmers disproportionally because of (inaudible) from Latin America with a rate kind of being much higher means there will be a shift as we restore profitability in some of the European market. But the biggest impact will come from the tax reform.

Operator

The next question comes from Thomas Seidl from Bernstein.

Q - Thomas Seidl {BIO 17755912 <GO>}

First question, back to ROE Slide 9. You showed us the new walk which is, as you say, (inaudible) gone higher than the previous one. And I wonder, with the (inaudible) targets being 9.75 to 14.25 and to cash target of $8.5 billion to $10 billion. Is the management of Zurich confident enough to sign up to higher targets? Not because it strikes me that what you're planning for is exactly lining with the upper end of the current (inaudible) targets? That's first question. The second one on Farmers. Last year, a double-digit loss in policies in force were more than compensated by double-digit rate increases. What do you think is the outlook for Farmers price increases still setting off policy losses in '18 and '19? Or is there risk that we see actually shrinking top line of Farmers once the price increases in U.S. motor are flatten out? And the third one is maybe on Life. You showed on Slide 20 that on an underlying basis you think that profits are up 22%, with investment margin up 16%. Some of your peers have also reported a strong Life numbers and you said that this was mainly driven by benign capital markets. I wonder is $1.4 billion the new run rate of Zurich? Or would you also say that there is $100 million, $200 million from just very benign capital markets in 2017?

A - George Quinn {BIO 15159240 <GO>}

Thanks, Thomas. So on the outset topic, (inaudible). Well first of all, we don't say our run targets. That's a decision that the boards and the sales make. We present the plans to the board. And the board decides how they word in management. I think we've made it clear already that -- I mean, there are things that as we come forward, we need to work into targets, for example, the acquisition of ANZ Life business in Australia. It's something that we said we did because that was less target. But obviously, it doesn't have an immediate impact right now. But I think the -- certainly over time, given the outlook that we have, I think you would expect that we would be challenged by the board on this topic. But we don't set this target, the board does. On the Farmers, I said that things -- actually, I mean, the message we're trying to give is actually quite positive. We gave you a look at the key metrics around the business both from a top line underwriting profitability perspective, even if you look at some of the leading indicators that the team used to judge what we would expect to see in the future, I mean, most of them point positively. We have achieved -- I mean the exchanges here have achieved a very significant improvement in profitability. Which as you point out, is rate driven. I mean, we look around the market who we think is competing with Farmers in that particular customer segment. And we think that entire segment of the market is going to continue to push for further improvement. I mean, if you look around, certainly, among some of the mutuals, I mean, you're going to see very substantial underwriting loses. So we expect next year to see growth on the Farmers business, together with the further improvement in the profitability for the exchange. On the Life side of things, I'm not sure I would say much more than I said to the earlier question. I mean, where do we see the BOP run rate? I would take the headline number for something like a mid-single-digit growth rate. Then to the extent that, I mean, if there's anything that was benign or favorable, I mean, that's incorporated in that guide.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. Maybe a quick follow-up on Farmers. With the U.S. tax reform, to what extent do you see at Farmers? And Farmers mentioned itself here, a price competition as local peers price in the lower tax rate?

A - George Quinn {BIO 15159240 <GO>}

Okay. I think you've got -- I mean, the most important thing here is we see different segments of that U.S. auto market. And in fact already -- I mean, that's a very price competitive segment. Price seeker is how we described them internally. There are, typically, well said by other providers in the market. There already is price competition. I mean, this wouldn't really change things substantially. You've then got another segment which, I mean, we talked about and you heard already I think from Jeff, Mike and Roy back in the Investor Day. And remember, what we see -- I mean, price is not unimportant. It's clearly something that is an important decision driver. But I mean the extent to which service, meeting customer expectations and providing with all the service we anticipate, I mean that's another very important part of the decision process. I think the challenge overall if you look at the U.S. market, particularly the companies that sell this particular product is that profitability is still a bit charged. So therefore, you can give -- you can put tax kind of in place. But if you're not making enough profit, it doesn't really change the equation, markedly. So I still expect based on the conversations I've had with the Farmers team, that we will see -- we'll see more rate to come in this business.

Operator

The next question comes from Michael Huttner, JPMorgan.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

A few questions. So on the Farmers growth if I can put it in another way. So the surplus did not change in 2017, about $25 billion. What -- given what you are kind of seeing in terms of Farmers' profitability, what could we see there in terms of -- what is the normal run rate given your expectations of profitability now; could sort of surplus increase by 5% or 10% as an interest to get a feel for it? And the reason I asked for that is, then we can put it in the same multiples as (inaudible), which will be very nice. The -- on the cash flow, the $3.7 billion, can you say what the figure would be if I kind of normalize everything? And I have no idea what I should normalize for. I imagine you've got hurricanes. I imagine you've got U.S. tax. But these are my imaginations. I'm not 100%. But the figures are high and I expected it to be lower because in that (inaudible) I'm just wondering do I add back anything? I mean, hired back the $700 million. It's an amazing figure. On the -- and then, just really little details, in the one offs you adjusted for in your lovely figure for the bar for $4.7 billion I think it is. Did you -- what was the adjustment for wildfires? And can you give a figure for that thing you mentioned a few times, that financial reserving, which I think was Spain. And I suspect is a thing which drives Europe's combined ratio higher? I can't think of anything else. That's it.

A - George Quinn {BIO 15159240 <GO>}

So on Farmers, the Farmers, without giving you a precise number. We're very dependent on interest rate. And typically the exchange is targeting high '90s combined. They believe that somewhere in that range allows them to generate enough (inaudible) grow what they -- the type of target levels that I mean, we've seen if you focus on the core operation for Farmers. So they're not looking for a 90 combined. They're looking for something in the 98%, 99% type territory. On the cash flow side. So first of all, on the cats. So the natural catastrophe, they actually have a quite a small impact in the current year. I mean, maybe a couple of hundred million dollars. Really de minimis. We do have some one-off, probably the most obvious example would be the reinsurance transaction we did around Sabadell back in the middle of the year. That released maybe a couple of hundred million dollars. There are a few other small things that are one-off in nature, typically positive, more than negative. I think if you normalize that, it would be a bit lower than 3.7. But it will still be slightly above the run rate required to deliver more than 9.5 billion over the planning period. But you certainly can't help the 700 to the 3.7 I'd love to do that. But you can't do that.

Q - Jonathan Peter Phillip Urwin {BIO 6126952 <GO>}

Just on the 3.7. But as you remember had the relocation of restructuring cost. Is the 3.7 net of that?

A - George Quinn {BIO 15159240 <GO>}

No. So the restructuring is in there. So remember when we said the -- I don't actually remember, what I tried to say when we set the 9.5 target is, if you think back we had delivered more than 9.5 over the prior 3-year period and it was a big discussion about the quality of that 9.5. And then, reality, that allowed for that restructuring cost that we intended to or expected to (inaudible). And your last question is of one-offs. So the challenge is, we could probably spend a couple of hours on this topic. I could probably have, maybe, 100 different one-offs all going in different directions. On the cat side, we picked on hurricanes because I mean, that's really the story. You take that out. And we're roughly where you expect us to be, give or take. And we picked out the other 2 obvious things, one, which I think people knew about, one of which we're announcing today. One, maybe, restructuring and operating. And the other being the U.K. topic. There are impacts from wildfires. But absent the hurricanes, there was an expectation that our impacts from commercial around financial lines in Europe. I think that topic, I mean, only if we take out the good news, only then, try and make an argument, we should take out the bad news. I mean, I think the rest of it is a wash. And the combined ratio in particular, the number that you've seen, is it a reasonable representation of where we are. We need to want to improve it.

Operator

The next question comes from Johnny Vo, Goldman Sachs.

Q - Johnny Vo {BIO 5509843 <GO>}

Just a quick question on investment income. Can you just comment on the trajectory of that investment income and where we are in terms of bottoming of that, particularly given the rate environment, the moving rate environment. Then, secondly, just on deployment of capital. Obviously, your IFRS book has moved up, which gives you some flexibility. That ECM looks very good. And SST looks all good. So in terms of areas of deployment for M&A, what areas would you look at? And would you necessarily use M&A to accelerate the shift in the P&C book that you're talking about?

A - George Quinn {BIO 15159240 <GO>}

Yes. Thanks, Johnny. So on the trajectory, 2 comments to make here. I mean, we think we're coming in to what we expect to be the last year of investment income compression. If we compare the good yields to investment yield we got that 20-basis-point GAAP on -- 30-basis-point GAAP on the P&C book. We're guiding people to assume we'll be down beneath that (inaudible) about $50 million to $100 million. On deployment of capital, again, I think the standard disclaimer first of all, we have no need to do M&A to achieve the target. I think it's important to emphasize that all the things that we've talked about in terms of the outlook for '18, with the exception of the Australia transaction, which is now something we're looking to complete. Everything else is organic. And everything that's in that walk in the ROE is organic. Now having said that, we clearly have the capability if there's something there that makes sense, I mean, we would like to move the balance of the book, not so easy to do it given the pricing at some of the assets. But you might want to go on to do that. I think our other priorities would be, frankly, bank assurance. We think we have core competency there. We can do more of that. We can certainly deploy capital in support of that. Then, generally, we made the point that as we look to simplify the organization and focus the organization in fewer markets where we have strength. I mean, if we have the ability to put capital behind management teams that have done a good job in a market where we can be more relevant. That's obviously a topic that would also be on the agenda for us.

Operator

The next question comes from Andy Hughes from Macquarie.

Q - Andrew Hughes {BIO 1540569 <GO>}

Three questions, if I could. Just still trying to get my head around the commercial deterioration ex weather between '17 and '16. I think you should do your own plan. And this was kind of projected in the right direction. Is the problem that you weren't aggressive enough in cutting some of these lines? And maybe because you had an expense target as well as a loss ratio target you, basically, are now looking at, again, are going to cut these lines more aggressively on commercial auto? Or I mean, is that what's going on here? And when can I see kind of a reduction in the top line significantly for the commercial business and this year? Then, the second question is on the retail and other line. Could you give the kind of '16 and '17 numbers ex CIS because I know that on that slide, you're saying ex catastrophes. And obviously, if I say ex had particularly good weather experience, how would you strip that out from there? Or what would that look like excluding that? And the final question is on Farmers. And I mean, I thought I really get the message that the forward-looking indicators for Farmers are positive because the key for a new business looks like it's in a number, looks like it's sort of 17% lower than it was two years ago, which kind of feed through -- are you seeing an increase in the net growth in the agent count? Or am I missing something that is obvious in there that is positive?

A - Mario Greco {BIO 1754408 <GO>}

So on the first point, if I had said on this call that I thought that commercial was on the line, I apologize. The team are working hard to improve it. (inaudible) weeks they'll have to do. I don't think it's because we've starved them in investment or we're trying to focus on the expense ratio. It's a tough market. There are issues out there that effect not only us. But other members or other market participants. We're not blind. And we look to improve further. And we expect to see that this year. On retail, other ex crop, I mean, I'll be honest, it's not a key performance indicator that I focus on. In fact, I mean, when we gave you ex cat numbers, we tend to exclude ex cat even for crops -- or cat for crops. So I think if I'm going to exclude retail -- or if I'm going exclude crop from those out, maybe I'd exclude commercial auto at the same time. Because one is about as far on the other side of their income as the other one is the other way.

Q - Andrew Hughes {BIO 1540569 <GO>}

All right. I'm just -- yes, just trying to work out what the improvement was...

A - Unidentified Speaker

Yes, can I -- sorry, can I make a clarification? We don't exclude cats. We only called for not including in the normal definition of the run rate of the business, the 3 events in North America, which are very extreme events. That's it. We include everything else. We take every earthquake, every flood, every storm, everything, whatever in the world. We just say the three events in America were their brutality and for the fact that they came all on top of the other in 3 weeks, they're quite special. And this should be considered on the side. Everything else is included, will remain included. And will always be included.

A - George Quinn {BIO 15159240 <GO>}

On Farmers, Andy I think, it's safe to say that it's going to take some time before you and I will Farmers the same time. Farmers -- I look at the improvements that we've seen from a profitability perspective, you see it clearly in the combined ratio. I look at the impact on the top line. And you can choose out of the quarter growth and the all end growth. And on the indicators, I mean, I appreciate that some of them are, maybe the best we can assume is slightly less negative than they were before. But you look at the trends. And in particular, look at customer satisfaction, which we is see is a really strong leading indicator of where the business is headed. And as Mario mentioned in the introduction, I mean we have a very strong performance with Farmers at the end of the year. We're happy with what they're doing. We're happy that you can see evidence of the progress. And we expect that to continue.

Q - Andrew Hughes {BIO 1540569 <GO>}

Sorry, I mean, the question about the (RCIS) was just to get a feel as to how much the business will improve by. That was the -- in terms of that 48 -- 94.8 against a 92.9. Just wondered how much of that was the crop business?

A - George Quinn {BIO 15159240 <GO>}

So crop is roughly the same level in terms of profitability than it was last year.

Operator

The next question comes from Mr. Vinit Malhotra, Mediobanca.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Just one question. Is that when we see rising interest rates. And obviously, is there a temptation within the group that some of the portfolio mixes should probably be differently done or because you know ultimately when this investment -- or when the Investor Day plan was launched, the rates were far lower. And there's obviously concentration that it would go far higher from here. But there's hope there. So I'm just curious, how do you look at this dynamic? Or how your teams look at this dynamic? And just on the Slide 18. Again, sorry to ask, just a clarification. The EMEA movement, is there some effect of rate inflation or those kind of things because (inaudible) inflation being a topic even in Europe becoming a topic. Just want to understand your view there as well.

A - George Quinn {BIO 15159240 <GO>}

So on the first one, at rising interest rates, Vinit. So maybe I'll start away from it. Let's talk about stats on asset risk. So maybe just being through the planning process this summer, I mean, Urban, our CIO, is recommending no major change on our asset stance. I think as you guys know, we had slightly reduced ex the exposure about a year ago. Since then, we've been broadly consistent. And at this stage, we're not anticipating a further significant shift. I mean, on the interest rate topic in general, I mean, that's typically more of an issue that feeds back into the pricing of the costing mechanism that we use. So if we did see a change in the risk-free interest rates, that's something that would certainly update our view of what the hurdle that had to be achieved would be. But not necessarily a change in portfolio mix. So SAA or strategic asset allocation for us anticipating it to be broadly stable.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Sorry, George, I meant the long tail was a short tail. I meant the -- I meant the business, not the assets.

A - George Quinn {BIO 15159240 <GO>}

So the -- I think -- so on that, again, I think we've made a strategic choice; we think we're too overweight on the long tail side of things. I think the interest rate outlook is something that has fed into that decision already. And the view that, that creates around things like inflation risk in the long term, that's a topic you'll continue to see as why can't we take in steps? And already this year, we talked about the fact that reinsurance could be a step in the right direction here. And we have put in place a reinsurance program to shift the mix of the portfolio. But we also intend to work on the incoming side of the boat to emphasize more the short tail lines. And trying to achieve a bit more balance in the portfolio, overall. Then, your last question was about, as expense is a big driver of the picture that you see on '18 figures, for example, in Europe and short summary, unfortunately, (inaudible) that's mainly driven by loss ratio.

Q - Vinit Malhotra {BIO 16184491 <GO>}

All right. And that's also a motor as you mentioned in the call already?

A - George Quinn {BIO 15159240 <GO>}

So motor tends to be a tough market pretty much everywhere. It certainly contributes to it. But a larger contributor in '17 would be financial license, for example.

Q - Vinit Malhotra {BIO 16184491 <GO>}

In EMEA?

A - George Quinn {BIO 15159240 <GO>}

Sure.

Operator

And next question comes from Dhruv Gahlaut, HSBC.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Just 2 questions. One, could you update in terms of reinsurance program if that's changed? And secondly, on the SST framework, you seem to point out to the reserve risk changes, which has led to the ratio coming down by about 10 points. Could you say a bit more in terms of where it's coming? Life, non-life? It's just, a lot has changed here.

A - George Quinn {BIO 15159240 <GO>}

Yes. Thanks, Dhruv. So on the reinsurance program, I think the only piece of substance that we have renewed on the cat side is for aggregate cat. I mean, no major changes in structure, pricing slightly up as you would expect given the market conditions. On the comment on the SST slides. So that was really to reflect the process we've been going through with FINMA, as they review proposed models and either approved or either asked for changes. I mean we have one issue where they've indicated that they would still want to see change before they'd be satisfied with it.

And that's reserve risk on the P&C book. I mean, we've estimated the impact that we anticipate from that. And as you can see, overall, this stage we still expect the SST ratio when we published it in April to be above 200. And that's a very comfortable position for us to be in. But that comment really reflects the ongoing conversation with FINMA and their expectations around how this should be modeled.

Operator

The last question for today comes from Ralph Hebgen, KBW.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Ralph Hebgen from KBW. I just have one question, which is left. And that relates to cash regain on Slide 34. I just would like to get a bit of handle, if possible, on the components of the cash that you show. So first, George, you mentioned a few one-offs. But in particular in life, I mean life is pretty strong, $1.1 billion shown here on slide. And I remember that your sort of guidance was to expect about $500 million or so from cash on an annual basis. So that is my first comment on the cash. And the second one is, my pickup that you're saying and nat cats, off the nat cats, there's only about, perhaps, $200 million or so in this. So if it is the case that only $200 million of the claims which you have received are cash effective this calendar year, is it therefore a fair conclusion to say that $500 million of cash negative impact will come in to this calendar year?

A - George Quinn {BIO 15159240 <GO>}

So very nearly on the second one. So the only thing you have to (inaudible) is tax. So we look at the, of course, tax loss of maybe around $600 million. So maybe another $400 million of impact from cats becoming the dividends that the businesses declare after the year-end. On the first one, obviously, one of the things that has changed since the point at which we gave the guidance around the $500 million per annum, a large part of the life business is European base. Solvency II just make a difference to the expected cash flow. And that certainly helps. And of course the one-off mentioned in response to Michael's question around Sabadell is also sitting in the life number.

A - Richard Burden {BIO 1809244 <GO>}

Okay. Thank you very much, everybody, for dialing in today. And we're aware that there are a number of outstanding questions from the call. And we will try and get back to everybody. The IR team is available all afternoon for further questions.

So thank you very much. And goodbye.

Operator

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