Q2 2017 Earnings Call

Company Participants

- Paul Norton, CFO and Head of Finance
- Philipp GmÃ¼r, CEO
- Ralph-Thomas Honegger, CIO

Other Participants

- Guilhem Horvath, Research Analyst
- Jonathan Peter Phillip Urwin, Director and Equity Research Insurance Analyst
- Peter Eliot, Head of Insurance Sector Research
- Stefan SchÃ¼rmann, Head of Insurances and Real Estate

Presentation

Operator

Ladies and gentlemen. Good morning. Welcome to the Half Year 2017 Results Conference Call and Live Webcast. I'm Sarah, the Chorus Call operator. (Operator Instructions) The conference is being recorded. (Operator Instructions) The conference must not be recorded for publication or broadcast. At this time, it's my pleasure to hand over to Philipp GmÃ¼r, Group CEO. Please go ahead, sir.

Philipp GmÃ¼r

Thank you. Ladies and gentlemen, I would like to welcome you to our conference call and the results of the first half of 2017. We can look back on busy and successful first six months 2017. Within the next 45 minutes, we would like to give you detailed information on our business development and the key financials of the reporting period.

Following my introduction, our CFO, Paul Norton, will go through the financial figures. I will then provide you with an update of the implementation of the helvetia 20.20 strategy. Following the presentation, Paul Norton and I as well as our Chief Investment Officer, Ralph Honegger, will be pleased to answer your questions, as always.

Let us turn to Slide #4. On Slide 4, I would like to share with you a brief overview of the main performance indicators. Paul will give you detailed information on the developments of these figures later on. Let us begin with the underlying earnings, which showed an excellent performance resulting in an increase of 8.4% to CHF 258 million in the first half year of 2017.

The improvement was driven by the nonlife and the life business. In addition to good technical results, in both business areas, the main driver was a higher investment result following the pleasing development of the capital markets from January to the end of June 2017. The business area, Other Activities, benefited from a better technical result from group reinsurance. However, due to the absence of one-off tax effects, which were included in the prior year. And slightly higher costs resulting from budgeted investments in strategic initiatives, underlying earnings decreased compared to the first half year of 2016.

The solid technical performance in the nonlife business is also reflected in the net combined ratio that improved by 0.6percentage points to 91.3%. Worth mentioning is the pleasing development of the net combined ratio in Europe, which decreased by 2.8percentage points, thanks to the successful portfolio restructuring and the benign claims environment.

Due to the very good progress of the integrations of Nationale Suisse and Basler Austria, underlying earnings included synergies of CHF 62 million pretax on a half year cost basis. In the prior half year, CHF 51 million synergies pretax were included in underlying earnings. The integration of Nationale Suisse and Basler Austria are almost completed.

Group business volume slightly increased by 0.3percentage -- % in original currency to CHF 5.5 billion. Nonlife business volume grew by currency-adjusted 3%. In the life business, the modern capital-efficient life products showed very pleasing growth resulting in an increase of 37% in original currency compared to last year. Nevertheless, due to the decline of volumes in the group life business -- because of the one-off effect last year -- and the planned reduction in traditional individual life business the total business volume in life was 1.9% lower on a year-on-year comparison. Thus, we are successful in developing our business mix according to our strategic plan.

I also want to highlight that the new business margin in the life business rose from 0.5% in the previous year to 1.2% in the current year. This improvement shows that we are well underway to successfully turning our new business to its modern, capital-efficient products.

Finally, annualized return on equity based on underlying earnings increased from 9.4% in the previous year to 10.2% in the first half year 2017.

Let us quickly have a closer look on synergies on Slide 5. As of the end of June 2017, Helvetia had 579 full-time employee equivalents, fewer than it had has -- has had of 30 June, 2014, when we started synergy tracking.

Of these employees, a net 498 left the company due to the 2 acquisitions and can, therefore, be counted as net staff synergies. Gross synergies were even higher. But we have increased personnel to support our strategy and to expand functions that Nationale Suisse had outsourced, which acted as a counter-effect. Finally, changes in the group structure, i.e., the sale of Belgian entity of Nationale Suisse and the acquisition of MoneyPark, resulted in a further net decline of 81 FTEs.

The staff reduction corresponds to around CHF 46 million in personnel cost savings on a half year cost basis. We also had nonpersonnel cost savings of CHF 16 million in the first half of 2017. In particular, synergies were achieved here through a reduction in redundancies in the areas of IT, logistics, marketing and corporate. Overall, I am happy to confirm once again that we are making great progress in achieving our synergy target.

Originally, we were setting forth a range of between CHF 105 million to CHF 130 million. In the meantime, we are confident to end up slightly above the higher end of that range.

With that, I would like to turn over the presentation to our CFO, Paul Norton, who will now provide you with the most important information about the key financial figures. Please, Paul.

Paul Norton {BIO 16145125 <GO>}

Thanks, Philipp. We're on Slide 7. Our underlying earnings for the first half of 2017 amounted to CHF 258 million and, therefore, increased 8.4% compared to the previous year. This increase was driven by both the nonlife and the life business.

One general point that I would like to mention is that all segments had positive one-off tax effects last year mainly due to the integrations. This year, the tax rates are in line with normal expectations, which means that all segments had a higher tax charge.

In the nonlife business, underlying earnings amounted to CHF 177 million and was 16.9% higher compared to the first half of 2016. In addition to a better technical result, the increase was mainly driven by a higher investment result as a consequence of the good development of the capital markets in the first six months. We will have a closer look on the nonlife profit by sources in a few minutes on Slide 11.

Underlying earnings of the life business were 4.2% higher at CHF 92 million. The increase was driven by a normalized strong risk result and a higher savings result. I'll provide you with more details on the profit by sources on Slide 14.

Result from other activities amounted to minus CHF 10 million against minus CHF 1 million in the first half of 2016. The technical result of our group reinsurance benefited from a better technical performance of the primary insurance lines and improved accordingly. However, due to the absence of one-off tax effects, which were included in the prior year and slightly higher costs resulting from budgeted investments in strategic initiatives, underlying earnings decreased compared to the first half year of 2016.

If we look at the segment results on Slide 18. All segments posted robust results in the first half of 2017. The Switzerland segment once again showed that it is a stable foundation to the group by reporting a profit of CHF 194 million. The increase was driven by both business areas: Nonlife and life. In the Swiss nonlife business, underlying earnings increased compared to the first half of 2016 by 19.7%, mainly thanks to a higher investment result.

The technical result was slightly weaker but still on a good level. Also, the life business showed 4.2% higher results on a half-year-on-half-year comparison. This was due to the increased operating result -- essentially a higher risk and higher savings result -- as well as higher gains in investments. Higher expenses for policyholder participation had a compensating effect. The segment result for Europe, which comprises the (market) units of Germany, Italy, Spain and Austria, increased by 11.8% to CHF 59 million. Both the nonlife business and the life business contributed to this profit increase.

Nonlife underlying earnings in Europe increased by 14.5%. The improvement is mainly driven by a significant better technical performance and a slightly higher investment result. Underlying earnings at the European life business also showed a positive development and increased by 4.6%. The improvement came from higher gains and losses from investments and slightly lower expenses for interest-related reserve strengthening.

A lower savings result and higher expenses of policyholder participation as well as our taxes -- we had some one-off tax effects in the European entities last year, had a compensating effect.

Specialty Markets includes the business lines Marine, Engineering and Art in the Specialty Lines Switzerland/International market unit, the French market unit specializing in marine reinsurance and the globally active reinsurance.

The segment result for Specialty Markets increased by 2.5%. A better technical performance and lower nontechnical costs were mitigated by higher taxes. As I mentioned in the beginning, last year, we had some one-off effects resulting in lower taxes and a lower net investment result.

The Corporate segment includes the corporate functions and group reinsurance in addition to the financing companies and the holding company. Its result of minus CHF 9 million decreased against the previous year figure of minus CHF 1 million, although the segment showed considerably improved results from group reinsurance, in line with the direct insurance units. The main reason for decline was that the previous year's result was affected by positive one-off tax effects. Furthermore, we had slightly higher cost due to the budgeted investments in strategic initiatives.

I'll continue with our growth on -- in business volume on Slide 9. In the first six months of 2017, Helvetia Group achieved a business volume of CHF 5.5 billion. This equates to a slight increase of 0.3% over the previous year in original currency. In the nonlife business, we achieved an increase in premium volume of 3% in original currency, which was driven by the active reinsurance business.

Life business volume was down by 1.9%. However, this is in line with our strategy as we move from less profitable and capital-inefficient products to capital-light and more profitable so-called modern insurance products: investment-linked solutions and deposits. These increased by a very pleasing 36.9% overall while traditional insurance solutions declined. The business volume in the group life business was down compared to the first half of 2016 because of a positive one-off effect last year.

Looking at the individual segments, business volume in Switzerland declined by 3%. I'll return to that on the next slide. In the Europe segment, business volume increased by 4.3% in original currency. Growth was driven by the country markets Austria and Spain. Both were able to grow the nonlife and the life business. In Germany, business volume was slightly increased, whilst in Italy, business volume declined. Germany was able to grow the life business due to the good performance of the modern life products. Nonlife volume by contrast was impacted by final acquisition-related portfolio restructurings. Italy was confronted with a market-wide declining motor insurance in the nonlife business. In the life business, the pleasing development of the modern products was not able to offset decline in volumes of the traditional business.

In the Specialty Markets segment, we also achieved a 13.8% increase in volume over the first half of 2016 (in) regional currency. Growth was driven by active reinsurance resulting from targeted diversification by region and business lines as well as the selected expansion of existing business relationships. With that, I'll now come to our home market, Switzerland, on Slide 10.

Looking at the Swiss market in more details, nonlife business increased while the life business was down mainly due to positive one-off effect in the first half of 2016. In nonlife business, we increased premium volume by 1.5% to just over CHF 1 billion. Growth was driven by property and accident and health. In the latter branch, we had carried out portfolio restructurings last year.

Business volume in life business went down by 4.7%, the biggest effect coming from the group life business. Here, single premiums decreased compared to the first half of 2016. In 2016, growth was impacted by a positive one-off effect due to a single transfer of policyholder bonuses into retirement assets, which was booked as premium. Without this one-off effect, single premiums would have risen. Regular premiums, which are important for assessing business performance, increased by CHF 6 million or 0.5%.

Finally, I'd like to highlight that demand for the modern, capital-efficient products sold through Swisscanto also grew very well. Already more than 40% of existing and 45% of new customers have policies with Swisscanto. Here, Helvetia only acts as the reinsurer for death and disability risks. In individual life business, premium volume decreased by 5.4% to CHF 425 million. Following the successful sale of our tranche product, Helvetia Value Trend. And good development of the Helvetia Guarantee Plan and Helvetia Payment Plan, product sales of modern, capital-efficient insurance solutions increased by 8.3%. However, this increase in modern products could not make up for the planned decline in traditional insurance solutions.

Now I'd like to take a look at the profit by sources in the nonlife business on Slide 11. Helvetia again showed a very strong technical performance in the nonlife business in the first half of 2017, which had affected the net technical result being 12% above the prior year. Looking at the profit by sources, you can see that the gross technical result, meaning before reinsurance, increased by 15% thanks to the successful portfolio restructuring in Switzerland, Italy, Germany and Spain. And the generally benign claims environment in the first six months of this year. However, because of recoveries from reinsurers, mainly of course from our own internal group reinsurance, this year were lower than the previous year's result. The net technical result improved by 12%. This was due to changes in our reinsurance structures between the units and group reinsurance with a different nature in many of the claims, which meant that the lower claims expense could be ceded to reinsurers than a year ago.

The investment result increased by 50% compared to the first half of 2016 and was, therefore, the main driver of the increase in underlying earnings. The capital market showed a good performance in the first six months of the year. As a consequence, we achieved higher capital gains investments. Finally, other nontechnical expenses and income as well as taxes were impacted by positive one-off effects in the prior year.

I'd now like to move to the net combined ratio on Slide 12. The net combined ratio improved over the first half of 2016 by 0.6percentage points to 91.3%. The improvement was strongly supported by the European segment, which reduced net combined ratio significantly by 2.8percentage points.

As a result of a much better claims development following the portfolio optimizations, gross claims ratio decreased significantly in almost all country markets. These developments also benefited group reinsurance as the European entities ceded lower claims expenses to group RI. The net claims ratio improved accordingly. The cost ratio, by contrast, increased by 1.1percentage points. Realized synergies were offset by higher commissions, budgeted investments in strategic initiatives and the above-mentioned changes in reinsurance structure. I'll give you some more details on this on the following slide.

In Switzerland, the net combined ratio increased to 84.5%. But it's still in a very good level. The claims ratio went up among other things due to higher large losses due to the fire in the sports center in Verbier, some NatCat at the end of June. But this is in line with normal fluctuations.

The cost ratio also rose. And I'll provide you with details on that on the following slide. Finally, I want to mention that all marquee units achieved combined ratios below 100%.

If we look at Slide 13, the cost ratio. Compared to the half year of 2016, the cost ratio -- the gross cost ratio went up from 28.1% to 28.9%, although this is entirely due to increases in net acquisition cost ratio. A large part of the increase is mainly due to the positive impact of higher volumes being offset by higher commissions, mainly in Switzerland. These resulted from growth but also from a temporary one-off effect due to the improvement of the methodology used in the calculation of the deferred acquisition costs. Synergies from the integrations led to a 0.4% improvement in the cost ratio. However, budgeted investments in strategic initiatives accounted for an increase of 0.4%, which offset the positive impact of the synergies.

We go to Slide 14, which shows the life business. The operating result increased by CHF 19 million or 10% against its prior year level. The improvement came from the risk result, which increased thanks to a normalized claims pattern compared with the prior year and a better savings results, which benefited from the decrease of the minimum interest guarantee in the group's -- in the group life business in Switzerland.

Higher gains and losses in investments and interest-related reserve strengthening, which remained on the same level as last year, were compensated by higher expenses for policyholder participation and taxes.

I'll now continue with new business margin and embedded value on Slide 15. On this slide, first what I want to highlight, as usual, that the new business margin, which is using the TEV methodology, not -- the more consistent embedded value methodology, as it lists improved by 0.7% -- points to 1.2%. This very pleasing development shows the impact by measures to improve profitability in the life business.

The value of the new business written increased from CHF 7 million in the first half of the previous year to CHF 20 million in the first half of 2017. Alongside higher new business volumes and more favorable interest rate assumptions, successful restructuring of our portfolio's additional products and the focused sale of modern products had the biggest impact.

The new business volume increased by 9% to CHF 1.6 billion. In Switzerland, the main driver of the improvement was the Swiss group life business with Swisscanto showing the highest growth rates in new business. In individual, life modern products also grew pleasingly. New business volume with traditional products, by contrast, was declining in line with our strategy.

The European entities also showed strong new-business volumes with modern products, mainly driven by large contracts in Austria. In all country markets, traditional savings products are now only offered selectively or in a modernized form, i.e., with noticeably reduced guarantees or guarantees upon maturity.

Helvetia group's embedded value was CHF 3.6 billion at the end of the first half year 2017, which means an increase of 24% compared to the same reporting period last year. The main drivers were model changes, a positive economic and operating profit. And a positive contribution from new business.

Slide 16 deals with our direct yields and guarantees in the life business. The direct yield and -- in Switzerland and the EU countries declined compared to the first half of 2016 as a result of generally lower interest rates. However, the interest margin improved in Switzerland from 0.95% in the first half year 2016 to 1.11%, to be accurate, in the current reporting period.

The increase of the interest margin in Switzerland was closely linked to low average technical interest rates on the liability side. The biggest impact resulted from the adjustment of the guaranteed interest rate for BVG retirement assets, as of 1st of January, 2017, from 1.25% to 1% for the mandatory part and a corresponding 25 basis point adjustment of nonmandatory rates.

The average technical interest rate in Switzerland is also lower because we've been successfully restructuring our portfolio of traditional products. Maturing insurance contracts with high guaranteed rates are being replaced by lower guaranteed rates. Additional reserve strengthening also had a positive influence on the interest margin.

In Europe, the interest margin shows a slight decline from 0.56% in the first half of 2016 to 0.53% in the first half of this year. As a result of decreasing interest rates and some older large-volume investments maturing, we see a stronger drop in direct yield compared to the average interest rate Helvetia has to generate in order to meet its obligations.

On the right-hand side of the slide, there's a graph showing the interest rate buckets on guarantees on group level. Whereas in the first half of 2016, only some 20% of group-wide life reserves had guarantees less or equal to 1%, this year, more than 40% reserves had average interest rates below that level. Whilst the lowering of the BVG minimum interest rate in Switzerland played a significant role here, it also shows how much we've done to restructure our portfolio to improve profitability and capital efficiency.

I would now like to move to the investment performance on Slide 17. The current income in the first half of this 2017 financial year was CHF 521 million. And thus at roughly the same level as last year. Direct yield was an annualized 2.2% and, therefore, more or less unchanged compared to the prior year.

In addition to current income, realized as well as book gains and losses amounted to CHF 78 million. This figure was driven by the good performance of equities in the first six months of this year. In total, the investment result recognized in the income statement was CHF 595 million, CHF 133 million up on the first half year of 2016.

Investment performance decreased 1% against 3.3% in the prior year period. Unrealized gains and losses recognized in equity only slightly decreased due to fact that interest rates remained relatively stable. In the first half of 2016, by contrast, unrealized gains and losses had increased significantly, favored by declining interest rates.

As we hold most of our bonds until maturity, such fluctuations in unrealized gains and losses can be neglected. Finally, we earned CHF 69 million more in assets backing investment-linked insurance solutions for our customers.

On Slide 18, you can see the investment result broken down by asset class. 2/3 of the current income of CHF 521 million came from bonds and mortgages, which contributed CHF 280 million. And respectively, CHF 44 million in absolute terms. Dividends accounted for CHF 55 million. And investment property for CHF 124 million. Gains and losses on investments were CHF 78 million, mainly driven by gains in equities. The minus CHF 162 million on bonds are resulting from FX effects which are mostly compensated by derivatives. Derivatives cover currency risks on bonds as well as price movements on equities.

The developments in nonrealized gains in equity was driven by lower gains and losses on bonds due to the slight increase in interest rates as well as the recovery in share prices. The unrealized gains in the bond portfolio, as a result, decreased by CHF 206 million.

The lower half of the slide shows the return on new and recurring investments. Around CHF 3 billion in total were reinvested or newly invested in the first half of the 2017 year, 78.9% of which were allocated bonds, primarily U.S. dollar bonds in the corporate sector, long-term U.S. Treasuries and Eurobonds. We had to contend with higher hedging cost to cover our foreign currency exposure. But on net debt basis, we earned a yield pickup, which allowed us to mitigate the negative and very low bond yields in Swiss francs to some extent. We also expanded the mortgage portfolio in line with our targets.

Finally, 5.3% were allocated to equities. In investment property, the main focus in the first half year was in renovations and maintenance. Direct yields and reinvestments totaled 1.5%.

I will finish my presentation with details on the capital position on Slide 19. I would like to remind you that we are, as usual, only in a position to report the full year 2016 SST ratio. Based on that, Helvetia still enjoys a solid capital position. SST ratio then was within the new target range of 140% to 180%. I understand that certainly you would like more information regarding exact SST figures. But given the great state of flux that the SST is in at the moment, the development of standard models and other initiatives by FINMA, it would make little sense to give you further details. Once the situation is stabilized and the formal BÃ¼FL reporting has been introduced, you'll obviously be able to have much more information around this topic.

Finally, the annualized return on equity based on underlying earnings improved from 9.4% to 10.2%. And on this note, I'll now hand over to Philipp GmÃ¼r again.

Philipp GmÃ¼r

Thank you, Paul, for the details of our financial performance in the first half of 2017. In a nutshell, we are happy with the development of our earnings, of our business volume and of our key figures, such as the combined ratio and the new business margin.

I would now like to come to the last part of our presentation and give you some more insights on strategy implementation. We will start on Slide 21. Ladies and gentlemen, when implementing the helvetia 20.20 strategy, we are putting a special emphasis on 2 aspects: The first focus is on our core business, because here we have strong existing customer relationships. We generate stable revenues. And we operate the business very profitably.

So one important pillar of our strategy is to strengthen our core business by optimizing our existing business operations to make them more efficient. At the same time, we aim to expand our business into adjacent fields to broaden our revenue base for sustainable growth. In a nutshell: by strengthening and expanding the current business model, we will build a stable foundation for the future to meet the changing needs of the customers.

In the programs initiated to transform the core business, we want to achieve, first, above-market organic growth in the profitable private and corporate customer segments; second, easy and convenient access to all our services and products through different channels, chosen by our customers; third, efficiency improvements in operations, e.g., automation or faster response times for our customers; as well as, fourth, focused churn management and cross; and upselling possibilities for Helvetia.

At our Capital Markets Day, we started -- we stated that we will spend CHF 25 million after tax for the implementation of strategic initiatives in 2017. The majority of these investments are allocated to these programs, which include projects such as SME effort, CRM or building up the ecosystem home where MoneyPark is already a first strong anchor.

To reinforce this, MoneyPark acquired Lausanne-based Defferrard & Lanz in July 2017, doubling its volume of brokered mortgages. The companies complement each other perfectly. MoneyPark is primarily present in German-speaking Switzerland and Ticino, while DL enjoys a strong position in French-speaking Switzerland. The merger will allow MoneyPark to tap into the strategically important market in French-speaking Switzerland in a quick and comprehensive manner. Helvetia welcomes this acquisition.

Ladies and gentlemen, strengthening the core business alone does not make a difference. We also have a laboratory where we want to drive innovation and explore new ideas in order to differentiate ourselves from our competitors. Our approach to innovation is characterized by a variety of different methods, which we are pursuing simultaneously. These include what we call prototyping of different ideas, investments in venture capital, internal start-ups through a corporate incubator and acquiring specific skills through M&A and cooperations.

As a result, we have a portfolio of so-called research and development-type projects, which we try out through prototypes. Successful ones are rolled out quickly to the organization. Unsuccessful ones are either modified or abandoned early. Current examples we are working on are the Chatbot or Famii, a family assistance app developed by smile.direct. Some of these will succeed and some will fail. I'm very proud, for example, that Helvetia is the first insurance company in Europe where customers can renew their contracts via SMS. What is important is that we have the courage, the culture within the company and the infrastructure to try out new ideas, obviously, within a clearly controlled overall budget.

At the end of May, the newly launched Helvetia Venture fund made its first investment in baimos technologies GmbH, Munich. Baimos offers award-winning and certified products relating to the digital management and authorization of access and locking systems. Also, in May, we established an innovation lab jointly with the University of St. Gallen. The lab aims at researching new business models and ecosystems for the insurance sector. The lab is part of the Institute of Technology Management with a special focus on innovation management at the University of St. Gallen.

Ladies and gentlemen, as you can see, we are making good progress on the implementation of our strategy helvetia 20.20. Our implementation approaches enable us to systematically and simultaneously strengthen and expand our core business while innovating and testing new business ideas in an agile approach.

This brings us to the end of the presentation. My colleagues and I would now be pleased to answer your questions. Thank you for your attention.

Questions And Answers

Operator

(Operator Instructions) The first question is from Peter Eliot, Kepler Cheuvreux.

Q - Peter Eliot {BIO 7556214 <GO>}

I had 3 questions, please. The first one was, if I look at the direct yield in Europe, it's down sort of 27 basis points over the last six months, meaning that the investment spreads has come in a bit. I was just wondering if you could comment on what's happening there and whether there's anything sort of funny going on there? And the second thing was on the runoff gains, which are lower than previous years. And I was wondering if you could give us anymore granularity there as well, in particular, if any countries had any -- or any parts of the portfolio has had any strengthening? Then the third thing was we're seeing some very nice claims improvements in Europe, especially Germany, I guess, where we had sort of around 6percentage points improvement. I'm wondering if you could just talk a little bit more about that, whether there's anything other than just sort of portfolio cleansing, whether there's anything else driving that?

A - Philipp GmÃ¼r

Okay. Thanks, Peter. I suggest that the first question relating to direct yields will be answered by Ralph. Question number two will be answered by Paul regarding the one-off gains. And I will then answer the third question. Ralph, please.

A - Ralph-Thomas Honegger {BIO 4932832 <GO>}

Okay. The direct yield in our European entities, as you know, you know the weight of nonlife-related assets in our European entities is much higher than in Switzerland since we have much more nonlife portfolio there. And therefore, the duration of the fixed income portfolio is much shorter. And we just had to reinvest in the first half year maybe a little bit larger sums at obviously lower interest rates. But there's no special effect at all.

A - Philipp GmÃ¼r

Okay. Paul?

A - Paul Norton {BIO 16145125 <GO>}

Runoff gains. I guess you'd be looking at Slide 30 in the package. I don't think runoff gains are being particularly lower than previous years. What we have -- one effect we do have is that any runoff gains this year -- a lot of runoff gains this year were ceded to group reinsurance, because effectively what they are is recoveries from prior year losses, which were paid by GRI and, therefore, have to -- they get recovered by GRI.

A - Philipp GmÃ¼r

Okay, with regard to the claims ratio in Germany, we are successfully underway in specifically looking at the risks we overtook due to the transaction with Nationale Suisse. Already the due diligence we saw. And we later on discussed that with you also that we are probably going down with the volume in Germany, slightly in order to improve our profitability. And finally, the claims ratio shows that we are well underway in better pricing our risks we had overtaken from Nationale Suisse especially. Okay?

Operator

The next question is from Jon Urwin from UBS.

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

So just a couple. So firstly on specialty. There's quite a strong growth, almost 15% in that unit. It just seems like quite a strange time to be growing so strongly given what we know about pricing and given what we know about sort of margins contracting. So any comments there would be great. And secondly, just a follow-up on improvement in the European combined ratios. It's good to see that coming through. And obviously, there's portfolio actions and pricing action working through. I mean, how much more can you do on that portfolio? I mean, where do you see the underlying quality of that book versus where it could get to? Then, where do you think that European combined ratio could get to if you put a normal claims load on there? It's obviously a bit benign for this period.

A - Philipp GmÃ¼r

Okay. Let us take Paul to answer the first question regarding the Specialty Lines. And I will then come up with updates to the European combined ratio.

A - Paul Norton {BIO 16145125 <GO>}

Yes. You raised a very good point. You're talking about the growth in the reinsurance business. As you probably remember, Jonny, we had a strategy to grow the reinsurance business, particularly to improve diversification. And that strategy is still in place. We're aware that we are in a soft market in certain areas. But we've been monitoring the strategy very, very closely. We actually had, just only last week, a very detailed deep dive into that expansion that's occurred in the last 2 to three years for those responsible. And we are confident that where they're writing business and how they're writing business, it's actually a good business. And they're finding -- because they're a follower, they're not a leader, they can find pockets of business which are well priced. And they have the discipline to avoid the mass business which isn't.

A - Philipp GmÃ¼r

With regard to the European combined ratio. I would like you to have a look at the Slide #29. We think that we are in good shape now with our strengthening the portfolios in the different country markets, especially Germany, Spain and to a certain extent also in Italy. And it's pretty tough to make a guidance with regard to the combined ratio. If you have a look at the different country markets, I mean, you see that we have very pleasing combined ratios. And as we say, we want to keep our combined ratio overall at this level. And we think it's ambitious enough to keep the portfolio in this shape and at the same time to realize our organic growth ambitions in the different country markets given the competitive environment we have.

Operator

The next question is from Guilhem Horvath from Exane.

Q - Guilhem Horvath {BIO 18460437 <GO>}

So I've got 3. The first one is going back on the investments' realized gains. And I'd like to understand what within these realized gains can be seen as somehow sustainable going forward and what you really see as an exceptionally high level of realized gains for H1? The second one is on synergies. And you reiterated the guidance of slightly more than CHF 130 million annually. Can you give a bit of an insight in terms of are you expecting to reach this level by year-end? And maybe -- or so is it going to be CHF 130 million, slightly above, or is it going to be close to CHF 140 million? Can you give a bit more of detail on where you expect to be? And third one is on expense ratio and the commission ratio. And you said it's linked to growth and to temporary one-off effect. I would like to understand how higher should we expect the expense ratio to be on a sustainable basis because of the growth environments going forward?

A - Philipp GmÃ¼r

Okay. Thank you, Guilhem. I ask Paul to answer questions number 2 and 3 regarding the synergies and the question of the sustainability of our cost ratio. And finally, Paul -- Ralph will answer question number one with respect to the realized gains. Paul?

A - Paul Norton {BIO 16145125 <GO>}

Okay. We do still expect to reach slightly above the CHF 130 million. I don't want to give a number at the moment. But it's not going to be massively above that. There is some uncertainty regarding some additional synergies in the Swiss market, where some of those may come through in 2018 as opposed to 2017. But we still believe we'll achieve the slightly above CHF 130 million this year. The expense ratio, the tendency is actually expense ratio in the second half of the year, the acquisition cost ratio, anyway, is slightly higher than in the first half of the year. The impact of the change in methodology -- or actually an improvement in the data that went into the methodology has increased the acquisition cost ratio by an amount this half year. And because it's allocated over the 2 half years, we should see a flattening out of that a bit in the second half of the year. We're talking about maybe half of the increase in the acquisition cost ratio was due to this change in methodology. And how much of that will flatten out over the second half year, haven't calculated in detail. So that bid offset. Then coming -- you'll have a slight increase due to the seasonality. So the long and short of it is, I expect the sustainable acquisition cost ratio to be slightly below where we are at the moment before we make any further measures.

A - Ralph-Thomas Honegger {BIO 4932832 <GO>}

Okay. Looking at realized gains, I mean, in the first half year 2017, they were mainly driven by equity since equity markets performed quite well in the first half year. I mean, looking at the performance in our book, including the derivatives for portfolio insurance, we almost had 7%, which is a nice performance. But I mean, it's not extraordinarily high. It's what you probably would expect on a long-term investment. Obviously, I mean this number might be quite volatile from year-to-year. But I would say, yes, it's in line. And that was the main driver of realized gains.

Operator

The next question is from Stefan SchÃ¼rmann from Bank Vontobel.

Q - Stefan SchÃ¼rmann

I have 2 questions. First one relating to life insurance. Can you maybe give some color how much you added to reserves, maybe also from a point of view group and Switzerland state? And second one, I'm still a bit confused about the whole cost of strategic initiatives. You, I think, made a guidance of around CHF 25 million net after tax for full year. We have now 0.4% in the nonlife, cost ratio included, which seems to be above that. Can you really provide how much you really basically added or needed for the strategic initiative on the cost side?

A - Philipp GmÃ¼r

Thank you, Stefan. I ask Paul to answer those 2 questions, please.

A - Paul Norton {BIO 16145125 <GO>}

Life insurance added reserves. Have we disclosed that? We have -- we don't disclose in the half year. You have to wait until the full year.

Q - Stefan SchÃ¼rmann

But can you say maybe more or less than last year or...?

A - Paul Norton {BIO 16145125 <GO>}

Roughly about the same as last year. Then the cost of the strategies, there's clearly seasonality involved. You can't just sort of double things up. At the moment, we've given you the 0.4%. We've also mentioned there's been increase that goes to the corporate segment. But for the half year, I don't want to disclose any more.

Q - Stefan SchÃ¼rmann

Okay. And basically going forward, it's definitely a '17 issue that's still going beyond or...

A - Paul Norton {BIO 16145125 <GO>}

Going beyond. We said in -- we said originally when we set our strategy, we're looking between CHF 50 million and CHF 70 million net income effect per annum. But obviously, '17 is really the first year of the sort of the ramp-up of these strategic initiatives. And that's why it cost us much less. But our aim for the following years is somewhere in the region of CHF 50 million to CHF 70 million.

Operator

The next question is a follow-up from Jon Urwin from UBS.

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

Just going back to the reserve releases quickly. So Paul, you mentioned earlier that they weren't particularly lower than a usual sort of normal run rate. But they fell by sort of 90 basis points year-on-year. That seems like quite a high number to me. From that, can we infer that the starting point is quite a big number?

A - Paul Norton {BIO 16145125 <GO>}

No. I think the big difference in the reserves, the runoff result. I don't like the word reserve release. It's the runoff result compared with the prior years is what I mentioned earlier is the relationship with the group reinsurance. This year, more of the claims were ceded to group reinsurance. Effectively, you're getting a payback to group reinsurance for the claims they paid in the prior years. And therefore, on a net basis, the runoff result decreased.

Operator

The next question is a follow-up from Guilhem Horvath.

Q - Guilhem Horvath {BIO 18460437 <GO>}

I've got 2 follow-up questions, please. The first one is on the guarantee side. Can you maybe give us a view on the individual Swiss life business, the same kind of split that you give on Slide 16 for group life, just to understand how much of guarantee do you have on this book and what's sort of the average level of guarantees? And the second is the comments you made on capital and the standard model for group life in Switzerland. Can you maybe update us on what's your current view on the potential for how your capital consumption in implementing this system and model going forward? So what's your -- what's the update you can give on discussion with FINMA today?

A - Paul Norton {BIO 16145125 <GO>}

Okay. The Slide 16 is both, in Switzerland -- you've got to combine the individual life and the group life. We don't separate them out into those 2 components. Now clearly, 2/3 of our local business is group life. So that gives you indication. The discussions with FINMA, I mean, how long do we want to talk about that? One of my least favorite topics. It is quite a difficult situation at the moment. I mean, everybody is -- for those just who maybe don't know or did but have forgotten, I'll do a recap. I mean, FINMA wants to do 2 things. It wants to standardize the models. And it started with the BVG business, which is fair enough to some extent, because there were too many individual models around. And the second thing that they want to do is they want more capital in the group life business, the BVG business. Their hypothesis is that they'll be rapidly increasing interest rates. And those rapidly increasing interest rates will lead to policyholders in BVG not renewing. They'll be seeking new contracts at better returns, better results, effectively, got massive policy cancellation risk, which leads in turn to liquidating assets, which would be held for long term at the loss. And there were -- this will effectively infect the individual life policyholders. So -- and cause a bit of a meltdown there. So what they want to do is to introduce what they call a runoff model, which effectively covers this risk. So you have to model not as if you are going concern. But as you are in runoff of the group life business, BVG business. And what they said is, you can continue to use the going concern model. But if you want to do that, you have to send in a plan to separate out the group life business legally. It's not told to you here exactly how that should be done. But the basic premise was probably a separate balance sheet, separate entity, which is obviously a huge undertaking to split it all out instead of a separate company with additional costs. So they've been at very short notice and very high pressure. Everybody's been producing -- particularly the test models, the runoff model and the going concern model. And strangely enough, in most cases, it doesn't show much of a difference in all 3 models. The existing model is a runoff model of a new standardized insurance model, which just shows the perils of trying to model complex business. And most people in the market are sort of saying, at the moment, it's not doing a great deal to us either way. And we could probably live with it. But it's clearly not what FINMA are intending. Because if you're coming up with similar results of the runoff model as you are to the going concern model, obviously, something's wrong with the basic models. So we expect a round of recalibration. But we still don't know what FINMA wants in terms of capital. We know what their ultimate view is. We need some kind of other capital, some kind of legal ring-fencing for the BVG business because of this rapidly increasing interest rate scenario. But how much capital that will be is difficult to tell. Clearly, their existing quick and dirty models have backfired in some respect in that -- in their aim. So we're still waiting.

A - Philipp GmÃ¼r

Okay. There will be quite a few discussions with our supervisory authorities during the coming months. Are there more questions?

Operator

(Operator Instructions) Gentlemen, there are no questions at this time.

A - Philipp GmÃ¼r

Okay. So I thank you very much for your attention. And I wish you all the best for the remainder of the day and the whole week. Thank you.

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. Good bye.