Q1 2015 Earnings Call

Company Participants

- George Quinn, CFO
- James Quin, Head of IR

Other Participants

- Andrew Broadfield, Analyst
- Andrew Ritchie, Analyst
- Dhruv Gahlaut, Analyst
- Farooq Hanif, Analyst
- James Shuck, Analyst
- Michael Huttner, Analyst
- Niccolo Dalla Palma, Analyst
- Nick Holmes, Analyst
- Paul De'Ath, Analyst
- Stefan Schuermann, Analyst
- Thomas Seidl, Analyst

Presentation

Operator

Ladies and gentlemen. Good morning or good afternoon. Welcome to the conference call on the results for the three months to March 31, 2015. I am, Sarah, the Chorus Call operator. I would like to remind you that all participants will be on a listen-only mode and 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 Mr. James Quin, Head of Investor Relations and Rating Agency. Please go ahead, sir.

James Quin {BIO 18345789 <GO>}

Good afternoon. Welcome to Zurich's Q1 results call. Our CFO, George Quinn, will make a few introductory comments and then will take your questions. As usual, please stick to two.

I'll now hand over to George.

George Quinn {BIO 15159240 <GO>}

Thanks, James. And good afternoon and good morning to everyone on the phone. So just to begin with, overall business operating profit for the Group was $1.3 billion in the First Quarter and net income attributable to shareholders was $1.2b. Both numbers are about 5% lower than in the prior-year period.

As you all know, currency has been a significant feature of the First Quarter. And it's likely to continue to be a feature over the course of this year. Currency is mainly a translational issue for us because we typically match the local currency liabilities and assets. And on a constant currency basis, BOP would have been broadly flat. And the 5% decline in gross premiums written we've announced in GI would have been a 5% increase.

From an operating performance perspective, we see this as a solid start to the year both in terms of top line and BOP, albeit with results for both Q1 and the prior period benefiting from a very low level of catastrophes. And we have a number of positive one-off items in both.

Let me turn to one other topic before I start the Q&A. With respect to solvency, you've seen that both Z-ECM and SST ratios have declined in the second half of last year. The Z-ECM ratio reduced from 126% at the half year to 122% at the end of the year. And SST declined from 215% to 196% over the same period.

There are three moving parts. So the first impact net of market movements is mainly flatter and lower yield curves, which reduced Z-ECM by around 6% and SST by around 13%. It's not all yield. But most of it is.

Second, allowing for expected growth that we expect to see in the business in (2014), that's had a negative 4-point impact on Z-ECM and a negative 5 on SST.

Then thirdly. And for Z-ECM only, these factors were partially offset by a change in how we model certain investment risks. This had a benefit of around 6percentage points.

The interest rate sensitivity that you see in the capital figures that we've disclosed today is greater than the previously disclosed simple parallel shift that we've given for two reasons. First and most important is convexity and our positioning. And the second is the second; and third-order effects that interest rates have on risk capital. And that has a particularly pronounced impact on SST.

Looking into the developments since the end of last year, we'd expect to see the Z-ECM ratio move lower in Q1 given the combined impact of currency movements and a further flattening and decline in bond yields, among other factors. And our best estimate is that we'll see a ratio in the upper half of our target range. In other words, still a very comfortable level. And given the levers that we have at our disposal to manage the overall risks, this does not impact our view of the deployable capital that we hold.

With that, we'll open up for Q&A.

Questions And Answers

Operator

(Operator Instructions) Michael Huttner, JPMorgan.

Q - Michael Huttner {BIO 1556863 <GO>}

Actually, yes, thank you very much. Two questions. I must say I actually thought these were really good results. But within that, because you've beaten a number of my estimates, where's -- you have this target range for return on equity of 12% to 14%. You reported 12.9%, which is excellent, excluding one-offs, 11.2%. So my two questions which are both on this.

Which, from your point of view, is actually the right figure? Is it the reported or the adjusted? And what's -- where is the main miss coming from? Is it still in life? Or are we seeing a bit of a drift also in non-life now? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Is that both of your questions, Michael?

Q - Michael Huttner {BIO 1556863 <GO>}

That's it. Yes.

A - George Quinn {BIO 15159240 <GO>}

Okay. So which is right? Obviously they're both right because they're both calculation. One is a headline number. But I think the more meaningful one is the underlying ROE performance because it -- that gives you a better sense of what you could expect from a go forward. And of course that's particularly relevant for the remainder of this year and next year to make sure that we're in that 12% to 14% ROE range.

If you look at the driver of why we're not where we expect to be, I think there are probably two key pieces. I think one is the same theme that you heard from us at the end of last year. So it's mainly GI. If you look at the GI combined ratio, if we adjust for cats and for one-off expense on both sides, the underlying ex-cat combined ratio hasn't changed very much; in fact it's almost exactly the same.

If you drill into it, we have a small improvement in attritional, which we believe is offset by large loss. But of course the large loss piece is an estimate rather than a science. Overall though, we need about 2; to 3-point improvement over where we ended last year on GI. We've only made a relatively small step in the right direction. So we need much more from GI to be in that 12% to 14% range.

Second is capital. We're still carrying more capital than we need. That obviously depresses the overall ROE. And as we've highlighted before and I guess we'll discuss during the course of this call, certainly we'll discuss again on May 21, capital deployment also has to figure in us achieving that 12% to 14% ROE.

Q - Michael Huttner {BIO 1556863 <GO>}

That's lovely. Thank you. So much.

A - George Quinn {BIO 15159240 <GO>}

Thank you.

Operator

Andrew Ritchie, Autonomous.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi there. One straightforward question. The large loss noise you alluded to in Q1, is that still the same area that's generating large losses that generated large losses in Q4, which I think was things like, for example, US commercial auto, Brazilian surety or is it new areas? And maybe just give us a sense as to is it revealing any issues or is it genuinely random?

Then on capital, you said in your opening comments, I think maybe I misheard you, that there was an effect in the required anticipate -- required capital 2014 growth. But I thought the ECM and SST took into account anticipated organic growth for 2015. So it's forward-looking in its requirements. Maybe if you just clarify that. And if that is the case, what level of organic growth is penciled into that number? And is that one of the levers, I guess, the financing of that future growth when you talk about levers and things you can pull? Thanks.

A - George Quinn {BIO 15159240 <GO>}

So on the second one first, I misspoke. It's absolutely 2015. Thank you for that. I guess as one of the levers, I guess levers sounds odd. I guess it's a margin of prudence that we have in the calculation. We've got about negative 4 and negative 5 points on Z-ECM and SST.

I apologize, I don't really want to give you a forecast for volumes for the year. But we -- even with the growth that we see in Q1, we're well beneath the level of growth that we had planned for and allowed for the capital calculations that you see. So we'd have a significant reduction in both that 4 and 5 if the current trend continued through the remainder of the year.

On the large loss side, I'm not sure whether it's good news or bad news. But they are completely different from Q4. We have a large corporate loss in North America. It's by far the largest single loss in the quarter. And we have some large losses in Europe, in particular the municipal business in the UK stands out as the source of two of them. So they're completely different from what you saw last year.

Q - Andrew Ritchie {BIO 18731996 <GO>}

The issues that cropped up in Q4, have they calmed down? Has there been development on them or have they not really come across your desk in Q1?

A - George Quinn {BIO 15159240 <GO>}

If you look at large losses overall, it's actually a touch higher than it was in Q4. But the theme, I guess there are no themes in large losses, are there? But the large losses that have occurred, you don't see the Brazilian topic crop up again and the other items you saw even then looked as though they were one-offs. So the themes in Q1 are completely different on the large loss side.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay. Thanks.

Operator

Andrew Broadfield, Barclays.

Q - Andrew Broadfield {BIO 7273415 <GO>}

Hi there. Good afternoon. Two questions. First one on the need for capital for the growth, you mentioned just now that you -- the Q1 had missed what you had hoped to achieve and therefore to consume. Can you just give us a little bit of an outline on where that -- why you failed to reach that growth target, what part of the business it was in and where you think you might be able to catch back up over the course of the year?

Then the second question is also in relation to solvency but in terms of what you anticipate. You talked about levers. Does it take into account things like the steady decline in Farmers Re quota share, etc.? That, although I know it's not in stone, is your intention. And I see the surplus improved again in the quarter at Farmers. So does it capture those sorts of actions within your plan?

A - George Quinn {BIO 15159240 <GO>}

So Andy, on the first one, all I can say in response to that, it's broadly across GI. If you look at GI in Q1, we've got pretty strong growth in global corporate. We actually think the headline there tends to overstate the growth that we expect to see from global corporates for the year.

Rate is generally still modestly positive. It continues the trend that we've seen through the course of last year, even if the absolute numbers by the various businesses or territories move around.

Where can we catch up? I don't know yet. We're obviously looking to find sources of profitable growth. And we've allowed for that in the capital requirement that we forecast for the year. I think it's too early to declare that we will or won't achieve that, albeit we're behind already in Q1.

On the solvency side, the anticipated levers, Farmers Re is -- I guess it's not a lever currently because it's -- we'll have the reduction already baked into the new figures for this year, which is the benefit of the -- the immediate benefit of the piece that's reinsured into ZIBB or Zurich Bermuda branch.

The levers I was thinking of are more of a combination of our ability to manage the required capital on the risk side because of the choices that we take and the way we allocate that capital. It's no surprise that the main consumer of capital requirements is market risk. And that's something that the firm can choose to have more of or less of as it sees fit.

On the available side, that's obviously a bit -- slightly trickier to manage it. We can manage capital structure, which can be helpful. But mainly on the available side, it would be the outcome of the year in terms of a finance performance and the impact of financial markets on the overall equity position that we have. But the levers for me are more obviously focused on the risk-based capital requirements and what we can do there to influence our capital consumption.

Q - Andrew Broadfield {BIO 7273415 <GO>}

So sorry, is it fair to assume that you make no assumptions around reduction in capital needs because of natural run off or changes that we, as a market, I guess we're expecting on Farmers Re and other areas?

A - George Quinn {BIO 15159240 <GO>}

No.

Q - Andrew Broadfield {BIO 7273415 <GO>}

Okay. All right. Thank you.

Operator

Paul De'Ath, RBC.

Q - Paul De'Ath

Yes. Hi there. Just a couple of questions on the life performance again, on Latin America specifically. So you've had obviously good performance in the Santander JV. But slightly disappointing in the Zurich-branded vehicles in Latin America. What's the driver there? Is that an active choice to favor the Santander JV or is there something else going on there? That's question one.

And secondly, just looking at the flows -- the net flows in the life business, the European flows have been very strong in the quarter compared to prior years. What's the key drivers behind that? Is that the corporate life and pensions business in the UK? And how much of that is coming from winning new schemes and how much is from general auto-enrolment type growth.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Paul. So first of all on the life performance in Latin America, it's not that we prefer the joint venture but we haven't -- we have one particularly large contract that we haven't rewritten this year. So that's largely why you've seen the underperformance on the Zurich-branded element of Latin America. Having said that, of course the -- I guess the contracts are sharper because of the very strong performance of the JV. It's produced a very, very strong growth in Q1.

On the net flows in Europe, I guess there are two or three main drivers. As you hint, CLP in the UK is a piece of it and it's a combination of both new schemes and contained enrolment. And also new product in Germany. So we have a new product that we distribute through a bancassurance partner and that's also had a positive impact on flows within Q1.

Q - Paul De'Ath

Is that a unit-linked-type product or is protection or what?

A - George Quinn {BIO 15159240 <GO>}

I'd guess you would describe it as a hybrid product. So it's -- if you look at our product mix, we don't sell significant volumes with guarantees. But typically many of the products have guaranteed elements. And this is a new product with a guaranteed element rather than an overall guarantee.

Q - Paul De'Ath

Great. Thanks.

Operator

Stefan Schuermann, Bank Vontobel.

Q - Stefan Schuermann {BIO 3235442 <GO>}

Yes. Good afternoon. Two questions. The first one still on the life part. You showed basically new business margins down in so-called other retail, which I think is mostly due to the traditional agent business in Germany and Switzerland. Can you maybe -- can we expect that stabilize or do you take any corrective action here, like cutting commission, or will that continue?

Then the second one on the Farmer surplus ratio that's standing at 39%. And you guide towards a decrease of 33% to 36% in the near future. So I'm not quite sure to understand why that should drop there.

A - George Quinn {BIO 15159240 <GO>}

Okay. So Stefan, on the first one, you're right; it is mainly Germany and Switzerland and it's the impact of rates on the business there. I think in the short term I don't expect it to stabilize. So I think you'll see a further reduction in new business values given the further reduction that we saw in rates in Q1 for both those markets.

Q - Stefan Schuermann {BIO 3235442 <GO>}

Maybe to -- volumes basically are up, new business volumes are up and margins are down. So you just continue like that or you don't take any corrective action there?

A - George Quinn {BIO 15159240 <GO>}

So two things. So I guess we do take corrective action. So if you look at where we sit in the league table on certain key measures, such as bonus, we're not at the top end by far. It's too early to determine what the outcomes for this year will be. But that's one of the levers that we have to significantly impact the overall financial performance. And there has to be a close correlation between what we're earning in the portfolio and what we share with the policyholder. That's one of the key levers for us.

I think just be careful. On new business value you could optimize purely for new business value. And I think you'd end up with potentially an even more negative outcome. So I think we try and look at both new business value and BOP when we're trying to make decisions about where we would prioritize growth. Germany and Switzerland are both very difficult though because of where interest rates are.

On surplus for Farmers. So the key reason you haven't seen it fall straight back into the target range is because of the way the calculation is done. The calculation is based on net written. So it's actually as they recapture the reinsurance, you'll see a bit more strength as a few more quarters come by. And that will cause, all things being equal and dependent on the earnings at the exchanges, the surplus ratio to fall. And we would expect to see it, again depending on the actual financial performance, fall back into the exchanges target range.

Q - Stefan Schuermann {BIO 3235442 <GO>}

Okay. Thanks.

Operator

Nick Holmes, Societe Generale.

Q - Nick Holmes {BIO 3387435 <GO>}

Hi there. Thank you very much. Two questions. First is on the GI expense ratio. Just wondered if you could share with us how you see the Q1 result developing throughout the year. I was really thinking, I guess, the upfront distribution costs that have taken us up 31%. Are they going to continue? And is 31% the sort of number that you would expect to see?

Then the second question is on US commercial pricing. Just wondered again how you see this developing. 2% rate change seems a pretty good result. Does this sum, do you think, throw doubt on what MarketScout have been saying about the appearance of a soft market? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thank you. So on the first one on the GI expense ratio, what you see for this quarter, before we take action on the efficiency side, is pretty what you'd expect. So there's no reason why, for example, the impact of the distribution would increase or decrease through the course of the year.

Having said that, I guess I made it clear at the year end and we're working on it currently, that the expense ratio that we see is too high. And that's a topic we'll specifically address when we have the investor update on May 21. So for the time being, based on what you see currently, the current level is reasonably indicative of what you would expect. But we have intentions to bring that number down.

Q - Nick Holmes {BIO 3387435 <GO>}

Right. And sorry, can I just ask, would that be for this year or is that looking out over the medium term, two, three years? Or perhaps you'd prefer to wait until the Investor Day to tell us.

A - George Quinn {BIO 15159240 <GO>}

Well the one thing I will say, Nick, is that medium term would be too long, with two to three years. As I mentioned to Michael in response to Michael's question, an improvement is required to make sure that we achieve the required return on equity that we have as a target. So that means it needs to be achieved over the course of the next 18 months.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay. Thank you.

A - George Quinn {BIO 15159240 <GO>}

On US commercial pricing the -- I guess the challenge is that -- it's bumped around a bit if you look at our rate monitor. I'm not sure I would describe it as a particularly positive environment. We've been in a position in the US for some time now where the rate change is roughly in line with loss cost inflation.

Q1, I think we've seen the market respond to some of the challenges. But where evident from a number of companies, including us in Q4, for example, in commercial auto, we've seen a number of areas where rate increase has been pushed through. But if you look at the market overall, we're still in the position where rate is covering what we think loss cost is increasing by, which means that margin is not currently expanding.

And also if you look at the individual lines, property still has pressures. That story hasn't changed recently. And auto workers' comp has a bit of pressure currently. So -- but I don't think it's particularly negative. I think I mentioned on the full-year call that I didn't share MarketScout's more negative outlook for the full year. But we certainly haven't turned any corners on the US pricing environment. And to be honest, I don't expect to see that take place over the course of this year. I think we'll see continued pressure.

Q - Nick Holmes {BIO 3387435 <GO>}

Right. Okay. Thank you very much.

Operator

Farooq Hanif, Citigroup.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi. Thank you very much. I apologize if this question has been asked because I wasn't right at the beginning of the call. But looking at your Z-ECM ratio, you make the comment obviously that Q1 has been tough because of interest rates. And obviously that's reversed quite strongly in Q2. So presumably if this is maintained, the current environment, then you will recover back up to the upper end of your capital rates or above the upper end. That's one question.

Then secondly, you have this 4 points of business profit uplifting your Z-ECM ratio. Is that a -- can we just normalize that for the year? And presumably you'll grow pre dividend 8 points a year in that Z-ECM ratio. Is that kind of a decent rule of thumb?

And lastly, in global life, you've mentioned that going to the $350 million or above the $350 million was harder because of FX. Has that got worse or better based on movements to date? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Farooq. So first on Z-ECM. So the only comments I provided are through the end of the quarter. And I've commented on the fact that given the continuing move on yield curves, we expected to see Z-ECM come down and we expect to be in the upper half of our range. And we still believe we're in a comfortable position because of the extent to which we can control our capital consumption.

I'm going to avoid commenting on what's happened post the end of the quarter. I guess I may mention that when we come back on the Investor Day. Interest rates, as they rise, particularly at the long end, particularly in some of the European markets certainly would be helpful. But I think we're going to be in a relatively volatile period for a time. So it will go up and down a bit. But I think the good news certainly from our perspective is that we have enough flexibility to manage.

On the business profit piece, the -- so I'm not sure exactly which -- so I guess if you're looking at the waterfall chart, you need to be a wee bit careful that you've got the business profit on one side and then you've got dividend on the other. So given the payout ratios, you tend to find that we pay back to our shareholders a very large proportion of the economic profit that we generate. So if it's 4.5 points and we have an accrual of, say, 3 points within the 5 that we've disclosed for dividend, it tends to be a relatively modest addition to the overall capital base because we're handing it back.

On the GL topic, maybe to give GL a bit of credit for what they have achieved, I think if we had stuck simply to the more than $350 million a quarter based on the foreign exchange levels when we first announced it, we'd be there already. But having said that, when we talk about more than $350m, we actually had in our mind a lot more than $350m.

Today as FX moves and particularly euro weakens against the franc, given the preponderance of earnings that GL has there, it becomes tougher. But when we looked at it earlier in the year, we were just above $350 million in terms of expectation once all the improvements had come through from GL.

The one point I'd like to add though, I was asked on the full-year call about GI and GI's expectation of growing their earnings by 5% comp. And I commented there that of course I didn't expect then to compensate for any possible FX movement. And the same is true for GL.

So we've stuck to the $350m. It's become tougher because of foreign exchange. But they've done a lot of what we'd expected of them already when we first announced this. But we still hold to the more than $350m.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. That's really clear. Thank you very much.

Operator

James Shuck, UBS.

Q - James Shuck {BIO 3680082 <GO>}

Hi. Good afternoon. I have two questions, please. Apologies for returning to the Z-ECM number. But I just wanted to pick up on something you said earlier on, George, that two of the reasons why the ROE is not hitting your target at the moment is, on the one hand, the GI combined ratio. But on the other hand, you have more capital than you need. I'm just struggling to see why that's the case because you're targeting 100 to 120 of Z-ECM and you're currently, on a Q1 basis, towards the upper end of that range.

I appreciate you've got some levers to manage. But I just wanted to understand whether you've actually got surplus capital and that's the way I should look at it, or whether this is more a case of, well, we're going to pull some of those levers and then that will release capital. And if that's the case, I just wanted to be clear that there's no modeling change to the plan. That is strictly around the required capital management. And when you consider the required capital, you're also considering what the impact is on the potential earnings growth, because obviously if you take less market risk than the outlook for earnings, it will come down even if volatility is improved. So that's my first question.

Secondly, just around the underlying accident -- the underlying loss ratio and the ex prior year. So if I look at the accident year, loss ratio improved 70bps in Q1 year on year. You had a higher large losses of about 1 point and lower nat cat of about 40 basis points. So in theory you have about 130 basis points of underlying loss ratio improvement there. I was just hoping for some insight geographically where that's been coming from, please.

A - George Quinn {BIO 15159240 <GO>}

Okay. So let me try and do the first one. So on the first one, I guess we've been pretty clear. Given the target range, we would try and measure ourselves off the midpoint of the target range. So 110. And if you think back to prior conversations about how much capital excess we had, we would often -- well I would often talk about the fact that if we have 16 points, 16 translates into, let's say, around $6b. But we don't have $6 billion because we have other constraints. And therefore we'd use the shorthand of 3. And in fact that was the basis for that additional step that you saw in the ROE walk that I presented back in London in December.

So part of what's happened to the second part of last year and the early part of this year is that I guess the constraints have come more into line with each other. Some of the rating models don't move as rapidly in response to some of these things as the Z-ECM. And in particular the SST. So the numbers have come down. But I guess the constraint picture has changed, if that makes any sense. So I don't see a fundamental change in the flexibility that we have.

On top of that, you're right; we have the ability to manage required capital. We need to be careful that we don't give up efficient earnings as part of that. But again, our peak capital requirement is for the financial market risk. And that's certainly something we manage actively and we have done in the past and we continue to do in the future.

Would modeling changes be part of the story? It would not. I think the -- one of the big differences you see between the two numbers today, between SST and Z-ECM, is that Z-ECM has the benefit of what we think is a significant improvement in the way that we model market and credit risk and the tail.

I think in due course we'll review that and may propose that to FINMA for inclusion in SST. But of course the acceptance of that by FINMA is purely at the discretion. And I would imagine that it would take some time from the point at which we would propose it. And we do need to manage the gap between Z-ECM and SST. So model change couldn't be a significant factor.

Q - James Shuck {BIO 3680082 <GO>}

And just to clarify one point, any decision on capital that you may not need, either because you can't find sources for it or it might make sense to return that, that presumably would be a year-end decision.

A - George Quinn {BIO 15159240 <GO>}

From where we stand today, yes. So I think the -- we'd make it -- again, going back to what I said at the year end, we work broadly to an annual cycle. So as we come up to the year end, we make any decisions there. But what we see in terms of inorganic or organic opportunities ahead of us versus return to shareholders in the early part of 2016 is decisive for us.

Underlying loss ratio. So I didn't quite understand the walk that you did. In my head I guess the numbers on the combined ratio were that the -- if you adjust for some of the one-off expense in the prior year, if you adjust for the cat fluctuation, we're about the same, that we have a positive impact and the attritional offset by negative on the large loss. So there's about a 60-, 70 basis-point improvement rather than -- you mentioned 130 basis points. But you may have included some of the things I'm normalizing out in my head.

The improvements we see are combination of various items. So it's something that we expect to drive profitability over the course of this year. So portfolio management, we describe it as tiering. So obviously emphasizing the positive parts of the portfolio and looking for significant rate in the weaker areas. And I mentioned commercial auto earlier in the conversation.

We've had some small steps on turnaround. So obviously Russia, from a loss perspective, is no longer in the picture. South Africa is slightly better, albeit Brazil is probably slightly worse than it was before. But those drivers are mainly the drivers of what we perceive the attritional loss ratio improvement to be in Q1.

Q - James Shuck {BIO 3680082 <GO>}

And North America commercial, how has the attritional loss ratio developed there at Q1?

A - George Quinn {BIO 15159240 <GO>}

Well overall, North America commercial has improved, both from underlying attritional and from a PYD perspective. So the results in North America commercial stand out as one of the -- as very positive Q1 this year over Q1 last year.

Q - James Shuck {BIO 3680082 <GO>}

Okay. Thanks very much.

A - George Quinn {BIO 15159240 <GO>}

Thank you.

Operator

(Operator Instructions) Thomas Seidl, Sanford Bernstein.

Q - Thomas Seidl {BIO 17755912 <GO>}

Thank you. Good day, everyone. Two questions. Number one, on the investment income side, we calculated you had a sharp drop year on year in regular investment income of 38 basis points. And I wonder, although in the context of, George, what you've just discussed, should we now expect Zurich to re-risk to mitigate a further sharp drop in the investment income or should we actually expect Zurich to de-risk in order to get more room to maneuver on the capital side? I'm not clear about that.

And the second question on the capital, I think there are more changes, of course. But in the end would assume (116). The model change is not, as you said, available in SST. And therefore from an outside perspective, SST appears the more robust metric. If I extrapolate the Z-ECM number you gave for Q1, I would say that SST is probably around the 180s now after Q1. And I wonder if you also have a threshold for this externally certified capital metric. So how low would you be willing to go on SST before it gets painful?

A - George Quinn {BIO 15159240 <GO>}

So if I start with the first one, again going back to the full year, we indicated that we had decided that we would change asset allocation in a couple of areas. And that was predominantly in equities. So we've given Cecilia and the team a 1% shift in the equity asset allocation predominantly away from fixed income.

On top of that, the IM team already had an existing strategy around illiquids. They've been completing that. They haven't completed it yet but they've been continuing to do that through the course of this year. And those two steps were really the only steps that we had planned to take on the asset side to help mitigate the impact of negative rates in some of the countries we discussed earlier in the call.

Will we take further steps? No. Cecilia has the ability to tactically decide to be slightly long or slightly short depending on market circumstances. But we have no further intention to shift the (SAA).

On Z-ECM and SST, I guess you can get a sense of where we're comfortable from an SST perspective from where we've operated in the past. 196 is still a very strong position for the Company to operate at. I'm not sure you can do what you just did and extrapolate the thing straight line. If you look at the moves we've had both for Q1 and some of the comments around what happened in April/May, I wouldn't get to the same level that you've estimated. But Z-ECM is where our focus is.

It think the point that you make though that we need to manage the gap is absolutely true. We haven't set a formal floor for SST as we would expect over time Z-ECM and SST to remain somewhat in some kind of harmony. But SST is not a formal part of the risk tolerance. And we're still very well capitalized under SST.

Q - Thomas Seidl {BIO 17755912 <GO>}

If anything, I would have expected SST to react more from it than macro risk materially in Q1 compared to Z-ECM. And that is also what we have seen in 2014, isn't it?

A - George Quinn {BIO 15159240 <GO>}

I think that's what I said at the beginning of the call. So SST reacts more strongly, principally because of things like market value margins and the way that calculation is done.

Q - Thomas Seidl {BIO 17755912 <GO>}

And hence I would have expected that the 196 you reported at the year end after Q1, it's easily in the 180s if you have a 10% drop on Z-ECM after Q1. That's just my -- of course not a linear extrapolation here.

A - George Quinn {BIO 15159240 <GO>}

Yes. I tried to give guidance around Z-ECM because we see that as the essential capital measure for us. I haven't given guidance around SST.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. Thanks, George.

Operator

Niccolo Dalla Palma, Exane BNP Paribas.

Q - Niccolo Dalla Palma {BIO 16052945 <GO>}

Yes. Good afternoon. Just one follow-up question. On a comment you made at the beginning of the call regarding the 2, 3 points combined ratio improvement needed in GI to bring you closer to the center of the target ROE, could you give us any sense of how big a role expense ratio improvement compared to underlying loss ratio improvement have to play in there? Or do we have to wait a couple of weeks to get more clarity on that? Thank you.

A - George Quinn {BIO 15159240 <GO>}

We'll do much more in a couple of weeks when we have the Investor Day. But we already said that of the 2 to 3 points' improvement, broadly about one-third from expense, almost one-third from turnaround and the remainder from portfolio management. That's roughly how we expect it to break down.

Q - Niccolo Dalla Palma {BIO 16052945 <GO>}

Thank you.

Operator

Dhruv Gahlaut, HSBC.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Good afternoon. Just two questions. Firstly we talked about pricing in different markets. But if you had to look at how the rate evolution has been compared to the claims, how would those two compare on a Group level?

Secondly, on the FMS business, there was commentary in terms of an uptick in terms of the expenses. Is that one-off or is this the number going forward?

A - George Quinn {BIO 15159240 <GO>}

So rate versus claims, broadly in line with each other. It varies market to market. But from a Group perspective one broadly equals the other.

On FMS. So the comment on expenses was due to the fact that last year we had a margin on FMS of about 7.2%. And I guess we'd guided that we'd be at 7% over the course of this year and next year. And we've arrived at 7% a bit more quickly, I think, than we had anticipated. That's due to that expense feature. But I don't expect it to go further. 7% is where it's (going to).

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Okay. Perfect. Thanks.

Operator

Michael Huttner, JPMorgan.

Q - Michael Huttner {BIO 1556863 <GO>}

Yes. And it is just one question. Thank you very much for all the answers from that. So life, $350m. You're keeping your target. That's brilliant. Or over $350m. We achieved $319m. Which reasons or which levers or which -- do you think there's a little bit of -- are there easy wins?

A - George Quinn {BIO 15159240 <GO>}

I think Kristof would shoot me for describing any of what he has to do as easy wins. I think the broad (book) is, Michael, via a combination of I guess what we refer to as in-force management in some of the more mature European markets. So that means expenses, persistency management, those types of things.

I think on the more positive side of it, given the growth that you've seen again from the joint venture with Santander in the quarter, we expect that also to be a pretty significant contributor to the growth on the positive side of what life is doing. Those will be the two most obvious areas we expect further improvement from life.

Q - Michael Huttner {BIO 1556863 <GO>}

And if I may just very briefly, if you were to consider selling the remainder of your UK business in a runoff deal, closed block or whatever, what impact would that have on your ROE metric?

A - George Quinn {BIO 15159240 <GO>}

The -- so I guess the only straight answer I can give that, Michael, is that we don't expect to sell the remainder of our UK life business.

Q - Michael Huttner {BIO 1556863 <GO>}

Okay.

A - George Quinn {BIO 15159240 <GO>}

In general we're looking at the entire life back book for opportunities to try and optimize, to find maybe parts of the portfolio that we find better owners who perceive a higher value. And that certainly would continue. But our life business in general is actually expected to contribute strongly positively to some of the strategic priorities that life has currently, particularly CRP.

Q - Michael Huttner {BIO 1556863 <GO>}

Brilliant. That's really clear. Thank you. Thank you.

A - James Quin {BIO 18345789 <GO>}

Okay. That was our last question. Thank you, all for dialing in. We wish you a very good day. And we look forward to seeing you at our Investor Day in Zurich in two weeks' time. Thanks very much.

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.
